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# From Pirates to Partners (Episode II): Protecting Intellectual Property in Post-WTO China

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# From Pirates to Partners (Episode II): Protecting Intellectual Property in Post-WTO China

## **Abstract**

In *From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century*, I criticized the ineffectiveness and short-sightedness of the U.S.-China intellectual property policy. As I argued, the approach taken by the administration in the 1980s and early 1990s had created a cycle of futility in which China and the United States repeatedly threatened each other with trade wars only to back down in the eleventh hour with a compromise that did not provide sustainable improvements in intellectual property protection. Since I wrote that article five years ago, China has joined the WTO and undertook a complete overhaul of its intellectual property system. Because of China's WTO membership, the United States can no longer impose unilateral sanctions on the country, as it threatened to do a decade ago. Instead, the United States has to resolve the dispute through the WTO dispute settlement process. As the U.S. administration is currently reviewing its options and preparing for a possible WTO dispute against China, it is timely and important to reopen the debate about how to design an effective American intellectual property policy toward China. This article begins by challenging the conventional view that the intellectual property law amendments introduced in China in the wake of WTO accession were mostly introduced to conform Chinese intellectual property laws to WTO standards. It argues that many of the amendments were created as responses to the emerging socialist market economy and the rapidly-changing local conditions in the country. In addition, the article takes on the recent proposals for the U.S. administration to file a formal complaint with the WTO Dispute Settlement Body over inadequate enforcement of intellectual property rights in China and explains why the United States should not do so. The article then explores alternative protection strategies by presenting five case studies in which intellectual property rights holders were able to protect their assets without relying on intellectual property laws. It questions the effectiveness of the litigious approach taken by foreign businesses while exploring differences between the Chinese and Western legal cultures. The article concludes by examining the progress China made in the intellectual property arena by focusing on three widely-reported incidents: the unauthorized reproduction, translation, and adaptation of Harry Potter novels, the State Intellectual Property Office's recent decision to invalidate Pfizer's patent in Viagra, and the Chinese authorities' heightened effort to protect trademarks used in relation to the 2008 Beijing Olympics.

## **Keywords**

Post-WTO, China, Intellectual property, Millennium Amendments, WTO Dispute

# FROM PIRATES TO PARTNERS (EPISODE II): PROTECTING INTELLECTUAL PROPERTY IN POST-WTO CHINA\*

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### INTRODUCTION

In the past year, there has been a growing debate about whether the United States should impose trade sanctions on China concerning foreign exchange, textile exports, and inadequate intellectual property protection. As Senators Charles Schumer (D-NY) and Lindsey Graham (R-SC) declared in June 2005, "the time has come for actions, not more words."<sup>1</sup> Four months earlier, they cosponsored a bill that sought to impose tariffs of up to 27.5% on all Chinese imports if China did not revalue its currency.<sup>2</sup>

In July 2005, the United States House of Representatives passed a bill that made it easier for American businesses to seek retaliatory tariffs against subsidized Chinese exports.<sup>3</sup> The Bush administration also put substantial pressure on the Chinese authorities to limit its textile exports and re-imposed import quotas to restrict the annual growth of certain textile products to 7.5%.<sup>4</sup> In addition, policymakers and the American public have severely criticized the bid of China's state-run CNOOC Ltd. to purchase the California-based Unocal oil company, citing national security concerns.<sup>5</sup>

1. Charles E. Schumer & Lindsey O. Graham, *Will It Take a Tariff to Free the Yuan?*, N.Y. TIMES, June 8, 2005, at A19.

2. S. 295, 109th Cong. (2005); see Edmund L. Andrews, *U.S. Warns China About Currency*, N.Y. TIMES, May 18, 2005, at A1 (reporting that "[t]he Bush administration warned China . . . that its currency policies were distorting world trade, and it brandished the threat of retaliation against the country's exports if Chinese leaders did not change course in the next year").

3. H.R. 3283, 109th Cong. (2005); see Warren Vieth, *Bush Wins Approval of Trade Pact*, L.A. TIMES, July 28, 2005, at A1 (reporting about the congressional bill that sought retaliatory tariffs against subsidized Chinese imports).

4. Elizabeth Becker, *U.S. Puts Limits on Clothing from China*, N.Y. TIMES, May 14, 2005, at C1 (reporting the Bush administration's announcement that it would impose new quotas on certain Chinese textile and apparel products).

5. See Steve Lohr, *Who's Afraid of China Inc.?*, N.Y. TIMES, July 24, 2005, § 3, at 1 (discussing the opposition of policymakers and the American public to CNOOC's bid

In response to this pressure, China voluntarily imposed export tariffs on its textile and apparel products,<sup>6</sup> and revalued its currency by pegging the yuan to a basket of foreign currencies, as compared to the U.S. dollar alone.<sup>7</sup> Meanwhile, CNOOC withdrew its unpopular \$18.5 billion bid for Unocal, leaving the company for its rival Chevron.<sup>8</sup> To mend the volatile bilateral relationship, Chinese President Hu Jintao also agreed to meet with President Bush in the White House in early September.<sup>9</sup> Among the issues to be discussed were textile exports, currency peg, intellectual property, nuclear nonproliferation, military buildup, trade surplus, and human rights. Although the trip was postponed due to the Hurricane Katrina disaster, the two presidents met during the sixtieth anniversary meeting of the United Nations General Assembly.<sup>10</sup>

To some extent, the recent developments are reminiscent of the turbulent U.S.-China bilateral relationship of the late 1980s and early 1990s. At that time, the United States had a significant trade deficit against China, as it does today. Because intellectual property-based goods were considered key exports that helped reduce the deficit, the first Bush and Clinton administrations sought to induce China to strengthen intellectual property protection by threatening the country with economic sanctions, trade wars, non-renewal of most-favored-nation status, and opposition to entry into the World Trade Organization ("WTO").<sup>11</sup>

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for Unocal); Jad Mouawad, *Congress Calls for a Review of the Chinese Bid for Unocal*, N.Y. TIMES, July 27, 2005, at C3 (reporting about Congress's proposed four-month study that would delay CNOOC's takeover of Unocal by many months); Leslie Wayne & David Barboza, *Unocal Deal: A Lot More Than Money Is at Issue*, N.Y. TIMES, June 24, 2005, at C4 (reporting about the opposition of congressional representatives, lawyers, bankers, and lobbyists to CNOOC's bid for Unocal).

6. China subsequently "lift[ed] self-imposed textile export tariffs in reaction to quotas on the exports by the United States and European Union." Chris Buckley, *China to End Its Taxes on Textile Exports in Retaliation for U.S. and European Quotas*, N.Y. TIMES, May 31, 2005, at C3.

7. David Barboza & Joseph Kahn, *Chinese to Stop Tying Currency Only to Dollar*, N.Y. TIMES, July 22, 2005, at A1.

8. See David Barboza & Andrew Ross Sorkin, *Chinese Company Drops Bid to Buy U.S. Oil Concern*, N.Y. TIMES, Aug. 3, 2005, at A1 (reporting about CNOOC's withdrawal of its bid for Unocal).

9. See Cragg Hines, *Why Hu Needs the Ranch Instead of the South Lawn*, HOUS. CHRON., Sept. 7, 2005, at B11 (reporting about the scheduled visit of President Hu Jintao of China).

10. See David E. Sanger, *Bush Puts Iraq, China and Iran on Agenda*, N.Y. TIMES, Sept. 14, 2005, at A6 (reporting about the meeting between the presidents of China and the United States during the sixtieth anniversary meeting of the United Nations General Assembly).

11. See Peter K. Yu, *From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century*, 50 AM. U. L. REV. 131, 140-51 (2000) [hereinafter Yu, *From Pirates to Partners*] (describing the United States' use of section 301 sanctions and various trade threats to induce China to strengthen protection of intellectual property

Against that background, I published an article in this *Law Review* called *From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century*,<sup>12</sup> which criticized the ineffectiveness and short-sightedness of the American foreign intellectual property policy toward China. As I argued, the coercive approach taken by the administrations created a “cycle of futility” in which China and the United States repeatedly threatened each other with trade wars, only to back down in the eleventh hour with a compromise that did not provide sustained improvements in intellectual property protection.<sup>13</sup> The article also expressed concerns about the resentment the policy had created among the Chinese people and its collateral damage to the United States’ longstanding interests in promoting free trade, human rights, and the rule of law.<sup>14</sup>

Since I wrote that article, China has revamped its intellectual property system, amending the copyright, patent, and trademark laws while introducing new implementing regulations, administrative measures, and judicial interpretations.<sup>15</sup> In December 2001, the country also joined the WTO.<sup>16</sup> Because of China’s WTO membership, the United States can no longer impose unilateral sanctions on the country concerning the lack of intellectual property protection, as it threatened to do a decade ago. Instead, the United States has to resolve the dispute through the mandatory WTO dispute settlement process.<sup>17</sup>

In February 2005, several trade groups urged the administration to file a formal complaint with the WTO Dispute Settlement Body against China concerning inadequate intellectual property protection.<sup>18</sup> Others, however, expressed concern that formal WTO

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rights).

12. *Id.*

13. *See id.* at 140-48 (discussing the “cycle of futility”).

14. *Id.* at 174.

15. *See* discussion *infra* Part I (discussing the legal reforms China undertook in the wake of the WTO accession).

16. China became the 143rd member of the WTO on December 11, 2001. For discussions of the ramifications for China’s entry into the WTO, see generally GORDON G. CHANG, *THE COMING COLLAPSE OF CHINA* (2001); NICHOLAS R. LARDY, *INTEGRATING CHINA INTO THE GLOBAL ECONOMY* (2002); SUPACHAI PANITCHPAKDI & MARK CLIFFORD, *CHINA AND THE WTO: CHANGING CHINA, CHANGING WORLD TRADE* (2002); Symposium, *China and the WTO: Progress, Perils, and Prospects*, 17 COLUM. J. ASIAN L. 1 (2003).

17. *See* Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994 [hereinafter TRIPs Agreement], Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, art. 64, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND, 33 I.L.M. 1197 (1994) [hereinafter Marrakesh Agreement] (mandating that disputes arising under the Agreement be settled by the WTO dispute settlement process).

18. *See* discussion *infra* Part II (discussing the request by trade groups to file a formal complaint with the WTO Dispute Settlement Body against inadequate

actions would affect their businesses by straining the U.S.-China bilateral relationship. As the administration reviews its options and prepares for a possible WTO case against China, it is timely and important to reopen the debate about the effectiveness of the American foreign intellectual property policy toward China. The fact that most of the existing legal research was published during the decade-old U.S.-China intellectual property negotiations makes the current debate even more urgent.

This Article draws on discussions in my earlier article and updates my thoughts on how the United States should convert the Chinese from pirates to partners. Although the Article focuses primarily on intellectual property protection in China, it also offers insight into legal developments in East Asia, other transition and less developed economies, as well as the nature, strengths, and weaknesses of the WTO system.<sup>19</sup> In addition, the Article explores larger questions about the difference between the Chinese and Western legal cultures, the unique nature of intellectual property protection, and the different considerations and concerns less developed and transition countries have about the one-size-fits-all intellectual property system pushed by the European Communities and the United States.

Part I of this Article examines the amendments China introduced to its intellectual property system at the turn of the new millennium. Although these amendments were introduced in the wake of China's WTO accession, this Part challenges the conventional view that these "millennium amendments" were mostly introduced to conform Chinese intellectual property laws to WTO standards. Instead, it argues that many of the amendments were created as responses to China's rapidly-changing local conditions. This Part highlights the importance of domestic factors in intellectual property lawmaking and suggests that the development of local stakeholders may hold the key to improving intellectual property protection in the country.

Part II articulates five reasons why the United States should not file a formal complaint with the WTO Dispute Settlement Body over inadequate enforcement of intellectual property rights in China. While this Part acknowledges that there will be benefits to using the WTO process against China in certain intellectual property disputes, it

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intellectual property protection in China).

19. See Pat K. Chew, *The Rule of Law: China's Skepticism and the Rule of People*, 20 OHIO ST. J. ON DISP. RESOL. 43, 47-48 (2005) (noting that "[b]y studying China, . . . one can also cautiously extrapolate some of what is learned to other developing countries', other Asian countries', and other transitioning socialist societies' perceptions of the rule of law").

contends that the general lack of enforcement of intellectual property rights does not present a strong case for the United States. In fact, if the United States pursues such a weak case before the WTO, there will be serious adverse implications for not only China and the United States, but also the international community at large.

Part III explores alternative strategies to protect intellectual assets owned by foreign businesses in China. This Part takes the position that, while enforcement of intellectual property rights is important, it is not the only tool through which American businesses protect their assets. This Part presents six hypothetical case studies to illustrate how intellectual property rights holders were able to protect their assets even when intellectual property laws were not effectively enforced. In exploring these case studies, this Part draws insight from not only legal literature, but literature in business strategies and China studies. Based on the success of the alternative strategies illustrated in these case studies, this Part questions the effectiveness of the legalistic approach usually taken by foreign businesses and explores the differences between the Chinese and Western legal cultures.

Part IV undertakes the difficult task of examining the progress China has made in the intellectual property arena. It focuses on three widely-reported legal disputes that provide insight into recent developments in Chinese intellectual property laws—in particular, the unauthorized reproduction, adaptation, and distribution of “Harry Potter” novels, the State Intellectual Property Office’s decision to invalidate Pfizer’s patent in Viagra, and the Chinese authorities’ heightened efforts to protect trademarks used in relation to the 2008 Beijing Olympics. This Part contends that, although the piracy and counterfeiting problems in China look familiar to what they were a decade ago, many of these problems are actually quite different and, therefore, warrant a new analytical perspective.

### I. THE MILLENNIUM AMENDMENTS

As China prepared to join the WTO, it undertook a complete overhaul of its intellectual property system, amending the copyright, patent, and trademark laws.<sup>20</sup> It also introduced a large number of

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20. Copyright Law of the People’s Republic of China (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 7, 1990, amended Oct. 27, 2001, effective Nov. 1, 2001) (P.R.C.), [http://www.sipo.gov.cn/sipo\\_English/flfg/xgflfg/t20020416\\_34754.htm](http://www.sipo.gov.cn/sipo_English/flfg/xgflfg/t20020416_34754.htm) [hereinafter Chinese Copyright Law]; Patent Law of the People’s Republic of China (promulgated by the Standing Comm. Nat’l People’s Cong., Mar. 12, 1984, amended Aug. 25, 2000, effective July 1, 2001) (P.R.C.), [http://www.sipo.gov.cn/sipo\\_English/flfg/zlflfg/t20020327\\_33872.htm](http://www.sipo.gov.cn/sipo_English/flfg/zlflfg/t20020327_33872.htm) [hereinafter Chinese Patent Law]; Trademark Law of the People’s Republic of China (promulgated by the Standing



implementing regulations and administrative measures. For example, the Measures on the Registration of Computer Software replaced the 1991 Regulations on the Protection of Computer Software,<sup>21</sup> and the new Regulations on the Protection of Layout-Designs of Integrated Circuits offered for the first time *sui generis* protection of layout-designs of integrated circuits.<sup>22</sup> To help courts interpret the many new laws and regulations, the Supreme People's Court issued a number of judicial interpretations.<sup>23</sup> As Xue Hong and Zheng Chengsi explained, "[a]lthough these judicial explanations are not legislation, they are binding within the Chinese judicial system . . . . The influence of these judicial explanations on IP rights of enforcement should by no means be overlooked."<sup>24</sup>

To make the Chinese intellectual property framework more complicated, international treaties provide additional protection that is not commonly found in the United States. As Article 142 of the General Principles of Civil Law stated: "where the provisions of an international treaty which the PRC has concluded or acceded to differ from the civil laws of the PRC, the provisions of the international treaty shall prevail, with the exception of those articles to which the PRC has made a reservation."<sup>25</sup> Although international treaties in China are far from self-executing, "a foreign plaintiff could cite any of the . . . treaties in a lawsuit against a Chinese entity if no domestic legal recourses are available, or if Chinese domestic provisions conflict with cited treaty provisions."<sup>26</sup> Nevertheless, as another commentator pointed out, "an international treaty is applied only when the relevant

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Comm. Nat'l People's Cong., Aug. 23, 1982, amended Oct. 27, 2001, effective Dec. 1, 2001) (P.R.C.), [http://www.sipo.gov.cn/sipo\\_English/flfg/xgflfg/t20020416\\_34755.htm](http://www.sipo.gov.cn/sipo_English/flfg/xgflfg/t20020416_34755.htm) (last visited Nov. 16, 2005) [hereinafter Chinese Trademark Law].

21. Measures on the Registration of Computer Software, *translated in* <http://www.chinagate.com.cn/english/433.htm> (last visited Nov. 16, 2005).

22. Regulations on the Protection of Layout-Designs of Integrated Circuits (promulgated by State Council, Apr. 2001) (P.R.C.), [http://www.sipo.gov.cn/sipo\\_English/flfg/zlflfg/t20020402\\_33873.htm](http://www.sipo.gov.cn/sipo_English/flfg/zlflfg/t20020402_33873.htm) (last visited Nov. 16, 2005).

23. *See, e.g.*, CATHERINE SUN, CHINA INTELLECTUAL PROPERTY FOR FOREIGN BUSINESS 66-67 (2004) (listing the new judicial interpretations that dealt with trademark protection).

24. HONG XUE & CHENGSI ZHENG, CHINESE INTELLECTUAL PROPERTY LAW IN THE 21ST CENTURY xxxvii (2002).

25. SUN, *supra* note 23, at 8 n.4 (translating article 142 of the General Principles of Civil Law).

26. *Id.* at 8-9. The many treaties to which China is a signatory include the Berne Convention for the Protection of Literary and Artistic Works, the Paris Convention for the Protection of Industrial Property, the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (which is commonly known as the Rome Convention), and the International Convention for the Protection of New Varieties of Plants ("UPOV"), among others. For a list of the international treaties to which China is a member, see *id.* at 8.

law is inconsistent with the treaty. If a Chinese domestic law is consistent with the treaty then local courts would apply Chinese law.”<sup>27</sup>

Due to the complicated nature of the Chinese intellectual property framework and the many reforms the country undertook in the wake of the WTO accession, this Part focuses primarily on the major amendments to the Chinese copyright, patent, and trademark laws.<sup>28</sup> Through the review of these amendments, this Part challenges the conventional view that the legal reforms were introduced primarily to conform the Chinese intellectual property system to WTO standards. Instead, it argues that many of the new amendments were created as responses to the country’s rapidly-changing local conditions.

Commentators often ignore the impact of local conditions (*guo qing*) on the Chinese intellectual property system. This Part, therefore, focuses on these conditions, in particular the Chinese leaders’ changing attitude toward the rule of law, the emergence of private property rights and local stakeholders, the increasing concerns about ambiguities over relationships in state-owned enterprises, and the government’s active push for modernization. By highlighting the local developments, this Part demonstrates the importance of domestic factors in intellectual property lawmaking and suggests that the development of local stakeholders may hold the key to improving intellectual property protection in the country.

Among the three major intellectual property laws, the patent law was the first to be revised, with amendments entering into effect on July 1, 2001.<sup>29</sup> There is no doubt that some of these amendments were introduced to conform the statute to the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPs Agreement”).<sup>30</sup> For example, the amended law now prohibits the “offers for sale” of

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27. Qingjiang Kong, *Enforcement of WTO Agreements in China: Illusion or Reality?*, in CHINA AND THE WORLD TRADING SYSTEM: ENTERING THE NEW MILLENNIUM 132, 139 (Deborah Z. Cass et al. eds., 2003) [hereinafter CHINA AND THE WORLD TRADING SYSTEM].

28. For comprehensive discussions of these amendments, see generally SUN, *supra* note 23; XUE & ZHENG, *supra* note 24; Jiwen Chen, *Better Patent Law for International Commitment—The Amendment of Chinese Patent Law*, 2 RICH. J. GLOBAL L. & BUS. 61 (2001) [hereinafter Chen, *Better Patent Law*]; Xiaoqing Feng & Frank Xianfeng Huang, *International Standards and Local Elements: New Developments of Copyright Law in China*, 49 J. COPYRIGHT SOC’Y U.S.A. 917 (2002); Yahong Li, *The Wolf Has Come: Are China’s Intellectual Property Industries Prepared for the WTO?*, 20 UCLA PAC. BASIN L.J. 77 (2002) [hereinafter Li, *The Wolf Has Come*]; Ruixue Ran, *Well-Known Trademark Protection in China: Before and After the TRIPS Amendments to China’s Trademark Law*, 19 UCLA PAC. BASIN L.J. 231 (2002); Louis S. Sorell, *A Comparative Analysis of Selected Aspects of Patent Law in China and the United States*, 11 PAC. RIM L. & POL’Y 319 (2002). The discussion in this Part benefits tremendously from these sources.

29. Chinese Patent Law, *supra* note 20.

30. TRIPs Agreement, *supra* note 17.

products that infringe upon invention patents and utility models.<sup>31</sup> It also tightens the standards for obtaining a compulsory license as permissible under Article 31 of the TRIPs Agreement<sup>32</sup> while allowing for judicial review of patent invalidations pursuant to Article 41(4) of the Agreement.<sup>33</sup>

However, local conditions and the rapid growth of domestic patent rights holders have created the need for other revisions, such as the simplification of the application procedures<sup>34</sup> and the elimination of the unnecessary duplication of the patent invalidation and revocation processes.<sup>35</sup> In addition, the amended patent law clarifies protection of an employee's invention by stating that the right to apply for a patent in such an invention belongs to the employer unless a contrary agreement exists.<sup>36</sup> To strengthen protection for both local and foreign rights holders, the law also requires innocent infringers to prove the legitimate source of the patented product.<sup>37</sup> Where damages cannot be determined, the law further allows for the calculation of damages based on appropriate royalties.<sup>38</sup>

The new copyright law was the second to be revised, entering into effect four months after the revised patent law. To comply with the TRIPs Agreement, the amendments expanded copyright subject matter to include architectural works, compilation works, and databases.<sup>39</sup> They also added to the statute the right of communication via information networks, public performance rights, and rental rights with respect to motion pictures, audiovisual works,

31. See Chinese Patent Law, *supra* note 20, art. 11 (prohibiting the 'offers for sale' of products that infringe upon invention patents and utility models).

32. See *id.* arts. 48-50 (tightening the standards for obtaining a compulsory license); see also TRIPs Agreement, *supra* note 17, art. 31 (laying out the conditions for the WTO member states to introduce compulsory licenses).

33. See Chinese Patent Law, *supra* note 20, art. 46 (providing for judicial review of patent invalidations); see also TRIPs Agreement, *supra* note 17, art. 41(4) (stipulating that "[p]arties to a proceeding shall have an opportunity for review by a judicial authority of final administrative decisions and, subject to jurisdictional provisions in a Member's law concerning the importance of a case, of at least the legal aspects of initial judicial decisions on the merits of a case").

34. See Chen, *Better Patent Law*, *supra* note 28, at 67-70 (discussing the simplified patent application process).

35. See Haitao Sun, Note, *Post-Grant Patent Invalidation in China and in the United States, Europe, and Japan: A Comparative Study*, 15 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 273, 286 (2004) (discussing how the revised patent law eliminated the unnecessary duplication of the patent invalidation and revocation processes).

36. See Chinese Patent Law, *supra* note 20, art. 6 (stipulating that the right to apply for a patent in an employee's invention belongs to the employer unless a contrary agreement exists).

37. See *id.* art. 63 (relieving users and sellers of liability if they can prove they obtained the allegedly infringing product from a legitimate source).

38. *Id.* art. 60.

39. Chinese Copyright Law, *supra* note 20, arts. 3(4), 14.

and computer software.<sup>40</sup> In addition, the amendments modified the fair use provision based on the three-step test laid out in Article 13 of the TRIPs Agreement.<sup>41</sup>

The copyright law amendments also contained many local elements. For example, the expansion of copyright subject matter to acrobatic art<sup>42</sup> is particularly important to Chinese rights holders, but less so to foreigners. As commentators noted, “[t]he purpose of the inclusion is to highlight characteristic Chinese works and to protect well-known acrobatics.”<sup>43</sup> The inclusion of databases in the copyright statute also can be partly attributed to the growth of domestic database producers.<sup>44</sup>

In addition, the revised law eliminates the double standards, or the “super-national treatment,” in which foreign nationals enjoyed stronger protection than Chinese nationals under the International Copyright Treaties Implementing Rules for domestic and foreign rights holders.<sup>45</sup> Taking into the account the growing number of Internet users in the country,<sup>46</sup> the statute addresses for the first time online copyright issues.<sup>47</sup> The amended law further requires that the assignment of property rights in a copyrighted work be in writing<sup>48</sup> and places the burden on the accused infringer to prove the existence of a legitimate license.<sup>49</sup> It also modifies the existing copyright licensing provisions<sup>50</sup> and includes a reference to recently-enacted Chinese Contract Law as a basis for the fulfillment of contractual obligations.<sup>51</sup>

The trademark law was the last to be revised and entered into effect only ten days before China’s WTO accession. Compared to its copyright and patent counterparts, the old trademark law “was [the]

40. *Id.* art. 10.

41. *See id.* art. 22 (enumerating the conditions for the fair use privilege).

42. *Id.* art. 3(3).

43. XUE & ZHENG, *supra* note 24, at 8.

44. *See id.* at 17 (noting that “[t]o boost the development of electronic databases, it was necessary to remove the limitation on the scope of compilation works, and extend copyright protection to original databases”).

45. *See id.* at 12 (discussing the double standards); Feng & Huang, *supra* note 28, at 919 (discussing the “super-national treatment” in which “foreign nationals enjoy better treatment under international conventions than Chinese nationals”).

46. *See* discussion *infra* text accompanying note 104 (discussing the exponential growth of Internet users in China).

47. *See* Chinese Copyright Law, *supra* note 20, arts. 10(12), 37(6), 41, 47 (addressing online copyright issues).

48. *Id.* art. 24.

49. *See id.* art. 52 (placing the burden on the accused infringer to prove the existence of a legitimate license).

50. *See id.* arts. 24-28 (setting forth the formal requirements for the licensing of copyrighted works).

51. *See id.* art. 53 (referring to the Chinese Contract Law as a basis for the fulfillment of contractual obligations).

most distant from the WTO rules.”<sup>52</sup> Many of the amendments, therefore, focused on conforming the law to the TRIPs Agreement. For example, the amendments expanded the registrable subject matter to three-dimensional marks and color marks<sup>53</sup> and added protection to certification marks, collective marks, and geographical indications.<sup>54</sup> In addition, the revised law strengthens and clarifies protection of well-known marks by recognizing unregistered well-known marks and delineating factors used to determine the “well-known” status of the mark.<sup>55</sup> The new law also removes the time limit for challenging marks acquired by fraud or other unfair means<sup>56</sup> and includes judicial review of all trademark office administrative decisions, including those on opposition and cancellation, refusals of registration, and trademark infringement.<sup>57</sup>

Apart from substantive changes, the amended copyright, patent, and trademark laws also strengthen enforcement of intellectual property rights. For example, the new laws now allow for preliminary injunctions that can be applied before or shortly after initiating the lawsuit.<sup>58</sup> In situations where the plaintiff’s damages or the infringer’s profits cannot be determined, the laws provide for maximum statutory damages of RMB 500,000 (about \$60,000).<sup>59</sup>

In addition, the laws allow enforcement authorities to confiscate income from infringing products and to impose fines on violators.<sup>60</sup>

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52. Chengsi Zheng, *Looking into the Revision of the Trade Mark and Copyright Laws from the Perspective of China’s Accession to WTO*, 24 EUR. INTEL. PROP. REV. 313, 313 (2002).

53. Chinese Trademark Law, *supra* note 20, art. 8 (offering protection to three-dimensional marks and color marks).

54. *Id.* art. 3.

55. *Id.* arts. 13-14. In determining the “well-known” status of a trademark, one must take into consideration the following factors:

- (1) reputation of the mark to the relevant public;
- (2) time for continued use of the mark;
- (3) consecutive time, extent and geographical area of advertisement of the mark;
- (4) records of protection of the mark as a well-known mark; and
- (5) any other factors relevant to the reputation of the mark.

*Id.* art. 14.

56. *See id.* art. 41 (exempting from the five-year limit those trademarks registered in bad faith).

57. *Id.* arts. 32-34, 43, 49.

58. *See* Chinese Copyright Law, *supra* note 20, art. 49 (providing for preliminary injunctions); Chinese Patent Law, *supra* note 20, art. 61 (same); Chinese Trademark Law, *supra* note 20, art. 57 (same).

59. *See* Chinese Copyright Law, *supra* note 20, art. 48 (providing for statutory damages); AIPI, *Punitive Damages as a Contentious Issue of Intellectual Property Rights*, at 1-2, [http://www.aiippi.org/reports/q186/q186\\_china.pdf](http://www.aiippi.org/reports/q186/q186_china.pdf) (stating that article 21 of the Supreme Court Patent Trial Provisions provided maximum statutory damages of RMB 500,000); Chinese Trademark Law, *supra* note 20, art. 56 (providing for statutory damages).

60. *See* Chinese Copyright Law, *supra* note 20, art. 47 (permitting enforcement

To help preserve evidence and property, the laws also authorize administrative agencies and courts to confiscate and destroy infringing products and materials, as well as the tools and equipment used in the manufacturing process.<sup>61</sup> Finally, foreign rights holders may enforce their rights through both local and national authorities.<sup>62</sup> All of the laws provide for criminal liability;<sup>63</sup> the trademark law, in particular, requires enforcement authorities to transfer cases to a judicial body for criminal investigation.<sup>64</sup>

Although policymakers, business executives, and commentators are generally satisfied with the major intellectual property amendments,<sup>65</sup> some aspects of the Chinese intellectual property laws remain inconsistent with the TRIPs Agreement. As Li Yahong observed:

[U]nder the Chinese Copyright Law, a computer program is still not protected as a "literary work." With respect to the Chinese Trademark Law, the following aspects are problematic: (1) only goods, not services, are mentioned in the protection of well-known marks, (2) registration is required for well-known marks, and (3) no protection is provided for geographical indications for wines and spirits. . . . Further, the Chinese Anti-Unfair Competition Law . . .

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authorities to confiscate unlawful income and to impose fine on violators); Chinese Patent Law, *supra* note 20, art. 58 (same); Chinese Trademark Law, *supra* note 20, art. 53 (same).

61. See Chinese Copyright Law, *supra* note 20, arts. 47, 51 (authorizing administrative agencies and courts to confiscate and destroy infringing products and materials, as well as the tools and equipment used in the manufacturing process); Chinese Patent Law, *supra* note 20, art. 61 (same); Chinese Trademark Law, *supra* note 20, art. 53 (same).

62. See SUN, *supra* note 23, at 11 (stating that "foreign companies can directly request administrative enforcement to be conducted by local IP authorities").

63. See Chinese Copyright Law, *supra* note 20, art. 47 (providing for criminal liability); Chinese Patent Law, *supra* note 20, art. 58 (same); Chinese Trademark Law, *supra* note 20, art. 59 (same).

64. See Chinese Trademark Law, *supra* note 20, art. 59 (requiring enforcement authorities to transfer cases to a judicial body for criminal investigation). Such an explicit provision is needed considering the limited number of cases transferred from the administrative authorities to police and prosecutors for criminal prosecution. As Daniel Chow noted:

[I]n 1997, of the 15,321 trademark infringement and counterfeiting cases brought by all levels of the AIC [Administration of Industry and Commerce] nationwide, only 57 cases, or 1 in every 269 cases, were transferred to PSBs [Public Security Bureaus] for prosecution. In 1998, of 14,736 trademark infringement and counterfeiting actions brought by AICs, only 35 cases, or 1 in every 421 cases, were transferred to PSBs. In 1999, of the 16,938 cases brought by AICs, only 21, or 1 in every 807 cases, were transferred to PSBs.

DANIEL C.K. CHOW, A PRIMER ON FOREIGN INVESTMENT ENTERPRISES AND PROTECTION OF INTELLECTUAL PROPERTY IN CHINA 217 (2002).

65. See Li, *The Wolf Has Come*, *supra* note 28, at 88 (remarking that the revised patent law is "the closest to being in complete compliance" with the TRIPs Agreement); Sun, *supra* note 35, at 280 (observing that "[a]mong China's IP laws, the Patent Law is considered the closest to being in complete compliance with TRIPs; any deviations are relatively minor").

requires “practicability” for a trade secret to be protected, while no such requirement exists in TRIPS. Finally, China has not provided protection for data concerning the marketing of pharmaceutical or agricultural chemical products that utilize new chemical entities, as required by TRIPS.<sup>66</sup>

Notwithstanding these inadequacies, policymakers and foreign rights holders have since turned their attention to enforcement reforms, rather than legal ones. Their only remaining statutory concerns involve the protection of trade secrets,<sup>67</sup> and the protection against unfair competition.<sup>68</sup>

When policymakers and commentators discuss the “millennium amendments,” they often describe the changes as a response to China’s WTO accession.<sup>69</sup> Even Chinese policymakers make similar statements, hoping that such a description would help earn goodwill in the international community while demonstrating to the outside world that China intends to be a respectful member of the WTO. For example, an official in the Chinese Ministry of Commerce has declared, “[i]n the IPR area, the amendment of IPR laws and regulations on a large scale was initiated with a view to bringing the IPR protection system in line with the requirements laid out by the TRIPS Agreement.”<sup>70</sup>

On their face, these statements seem valid. The WTO Agreements and China’s accession agreements, for example, have called for greater transparency, the provision of judicial review, and rule of law

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66. Li, *The Wolf Has Come*, *supra* note 28, at 88-89.

67. See SUN, *supra* note 23, at 91 (observing that “China has not adopted any new national procedure or substantive rules offering civil or administrative remedies to proprietors of trade secrets since 2001”). As Peter Feng pointed out, trade secrets in China originally “were by definition a matter of state secrets,” because the society was “dominated by a centrally planned socialist command economy.” PETER FENG, *INTELLECTUAL PROPERTY IN CHINA* 385 (2d ed. 2003). However, as China undergoes transition from a command economy to a socialist market economy, trade secret protection has been increasingly inadequate.

68. See Chengsi Zheng, *TRIPS and the Amendment of Unfair-Competition Laws in China*, in *CHINA’S PARTICIPATION IN THE WTO* 231 (Henry Gao & Donald Lewis eds., 2005) (discussing the inadequacy of the Chinese unfair competition laws and the need for reforms to enable the laws to comply with the TRIPS Agreement).

69. See, e.g., OFFICE OF THE USTR, 2005 NATIONAL TRADE ESTIMATE REPORT ON FOREIGN TRADE BARRIERS 95 (2005) [hereinafter 2005 NTE REPORT], [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2005/2005\\_NTE\\_Report/asset\\_upload\\_file469\\_7460.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/2005_NTE_Report/asset_upload_file469_7460.pdf) (stating that, “[i]n anticipation of its accession to the WTO, China began modifying the full range of IPR laws, regulations and implementing rules, including those relating to patents, trademarks and copyrights, in an effort to comply with the TRIPS Agreement”).

70. Shi Miaomiao, *China’s Participation in the Doha Negotiations and Implementation of Its Accession Commitments*, in *CHINA’S PARTICIPATION IN THE WTO*, *supra* note 68, at 23, 32 [hereinafter Shi, *China’s Participation in the Doha Negotiations*].

developments in China.<sup>71</sup> Article 41(4) of the TRIPs Agreement also specifies an obligation in the WTO member states to provide judicial review of final administrative decisions.<sup>72</sup> Upon close scrutiny, however, these statements are incomplete, if not misleading. While the amendments were undeniably introduced at a time when China prepared to enter the WTO, it is an overstatement, or a half-truth, to claim that the amendments were introduced primarily to conform the Chinese intellectual property system to WTO standards. Such a statement would ignore the important changes in the socialist market economy, the internal dynamics of the intellectual property lawmaking process, and contributions of the local stakeholders in the legal reforms. More problematic, by creating a misimpression that external pressure was the key to improved intellectual property protection in the country, the claim would misguide the development of future U.S.-China intellectual property policies.

Indeed, the TRIPs Agreement did not require many of the millennium amendments; rather, they were necessitated by China's rapidly-changing local conditions, such as the emergence of the socialist market economy, the growing constituency of domestic rights holders, and the need for economic stimulus to accelerate China's modernization efforts. To illustrate the impact of these domestic factors on intellectual property law reforms, this Part focuses on the provisions concerning an employee's invention, the use of contracts, private collective societies, online copyright infringement, and geographical indications.

#### A. *Socialist Market Economy*

Article 6 of the Chinese Patent Law provides that the right to apply for a patent for an employee's invention belongs to the employer unless a contrary agreement exists.<sup>73</sup> The amended law eliminates an ambiguity of the old law concerning situations where the employer's

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71. See, e.g., *Rule of Law Issues in China's Accession to the WTO*, INT'L L. NEWS, Winter 2003, at 4 (reviewing comments by the ABA's China Law Committee regarding China's efforts to comply with international standards).

72. TRIPs Agreement, *supra* note 17, art. 41(4) (stipulating that "[p]arties to a proceeding shall have an opportunity for review by a judicial authority of final administrative decisions and, subject to jurisdictional provisions in a Member's law concerning the importance of a case, of at least the legal aspects of initial judicial decisions on the merits of a case").

73. See Chinese Patent Law, *supra* note 20, art. 6 (stipulating that, "[i]n respect of an invention-creation made by a person using the material and technical means of an entity to which he belongs, where the entity and the inventor or creator have entered into a contract in which the right to apply for and own a patent is provided for, such a provision shall apply").



equipment and resources were used to create the patent-seeking invention.<sup>74</sup> As Peter Feng noted years ago about the protection of software, which is similar to that of patents, there was always “the notorious classroom conundrum: who owns the copyright of software if it was developed outside one’s normal and assigned duty, but with the assistance of the material means of the employing unit.”<sup>75</sup> The revised patent statute, however, has made the answer to this question clear: if the employee has an agreement, the law gives the employee the right to apply for a patent in China.<sup>76</sup>

This revision reflects the many economic changes in China in the past decade. While state-owned enterprises dominated the Chinese economy a decade ago, the number of private enterprises has greatly increased, and a large number of employees of state-owned enterprises are now rushing to enter the private sector. In the software industry, for example,

many software engineers [in recent years] resigned from state enterprises or research institutes, taking software products (finished or unfinished) created during the course of employment with them, and joined private software companies or established their own companies. These private companies immediately produced and marketed the software products, and became competitors of state software enterprises.<sup>77</sup>

What was once a “classroom conundrum,” therefore, has now become a major business problem.<sup>78</sup> The revised Article 6, therefore, was needed even without the WTO accession.

Consider the use of contracts in copyright law, as another example. Although the implementing regulations of the old copyright statute required that copyright contracts and licenses be in writing, “the old . . . Copyright Law did not specify that copyright assignment and licensing must be in writing.”<sup>79</sup> The copyright law amendments, however, clarified the law by requiring a written contract for the assignment of rights protected under the law<sup>80</sup> and by upgrading the

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74. See Chen, *Better Patent Law*, *supra* note 28, at 66-67 (discussing the ambiguity in the definition of an employee’s inventions).

75. PETER FENG, *INTELLECTUAL PROPERTY IN CHINA* 132 (1st ed. 1997).

76. See Chinese Patent Law, *supra* note 20, art. 6 (stipulating that the right to apply for a patent for an employee’s invention belongs to the employer unless a contrary agreement exists).

77. XUE & ZHENG, *supra* note 24, at 104-05.

78. See *id.* at 105 (noting that “ownership disputes over the software developed by the employees become a hot issue in China”).

79. SUN, *supra* note 23, at 54.

80. See Chinese Copyright Law, *supra* note 20, art. 25 (stipulating that “[a]ssignment of a right referred to in Article 10, paragraphs (5) to (17), of [the Copyright] Law shall require conclusion of a contract in writing”).

requirement from a lower regulation-level authority to a higher statute-level authority.<sup>81</sup> Article 53 of the Chinese Copyright Law also includes, as a basis for the fulfillment of contractual obligations, a reference to the Chinese Contract Law.<sup>82</sup>

In addition, the Law includes provisions that cover assignment of rights and use of contracts. Although copyrights had been widely assigned before the most recent amendments, assignment of rights had not been formally included in the copyright statute. The 1990 Copyright Law, for example, included “a chapter on copyright licensing contracts, but there was no provision concerning copyright assignment.”<sup>83</sup> The amendments thereafter “expanded [the copyright law] to cover the assignment of property rights in a copyrightable work.”<sup>84</sup> In addition, the law permits contracting parties to freely negotiate the duration of their licenses,<sup>85</sup> as compared to the ten-year renewable terms stipulated in the old copyright law.

Combined together, the above two examples show Chinese leaders’ increasing comfort with the market economy, protection of private property, and freedom of contract. This growing comfort has become especially apparent when one contrasts it with the dilemma Chinese policymakers had when they were considering whether they should introduce a new patent system in the mid-1980s.<sup>86</sup> On the one hand, they wanted to create a stimulus for inventions and to rehabilitate scientists, inventors, and academics, many of whom suffered during the Cultural Revolution.<sup>87</sup> On the other hand, they were greatly concerned about the changes a new system would bring to the country’s command economy, which was quite different from today’s socialist market economy. As a result of this dilemma, early Chinese

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81. See Feng & Huang, *supra* note 28, at 920 (noting that “a unique dynamic behind the revision of the 1990 Copyright Law is the upgrading of certain fundamental features from lower level authorities, particularly the 1991 Regulations, to the Copyright Law itself”); see also Kong, *supra* note 27, at 135-36 (discussing the hierarchy of Chinese laws and regulations at the national and provincial levels).

82. See Chinese Copyright Law, *supra* note 20, art. 53 (referring to the Chinese Contract Law as a basis for the fulfillment of contractual obligations).

83. XUE & ZHENG, *supra* note 24, at 22.

84. See SUN, *supra* note 23, at 54 (noting that the assignment of rights had not been formally included in the 1990 Copyright Law).

85. See Chinese Copyright Law, *supra* note 20, arts. 24-25 (setting forth formal requirements for the licensing of copyrighted works).

86. See Yu, *From Pirates to Partners*, *supra* note 11, at 136-37 (discussing the reluctance of Chinese leaders to introduce a new intellectual property system that might conflict with the socialist economy).

87. See WILLIAM P. ALFORD, *TO STEAL A BOOK IS AN ELEGANT OFFENSE: INTELLECTUAL PROPERTY LAW IN CHINESE CIVILIZATION* 65 (1995) (stating that China’s post-Cultural Revolution leadership believed “the promotion of scientific and other intellectual work to be crucial if the nation were to make up for the decade of development and training lost to the Cultural Revolution”).

intellectual property laws were filled with compromises that resulted in what commentators have called “socialist legality with Chinese characteristics.”<sup>88</sup>

In 1992, following Deng Xiaoping’s famous “tour” in Southern China, the National People’s Congress incorporated the concept of the socialist market economy into the Chinese Constitution.<sup>89</sup> Amended in March 1993, Article 15 of the Constitution now reads: “The state has put into practice a *socialist market economy*. The State strengthens formulating economic laws, improves macro adjustment and control and forbids according to law any units or individuals from interfering with the social economic order.”<sup>90</sup> In 1997, the private sector was designated an important component of the changing economy, and “red capitalists” were invited to join the Chinese Communist Party at the Sixteenth Party Congress four years later.<sup>91</sup> Today, the Constitution stipulates that “[c]itizens’ lawful private property is inviolable,”<sup>92</sup> and the real estate markets in major Chinese cities have been booming.

As the Chinese socialist market economy develops, some of the compromises in the early intellectual property laws are no longer needed. As two Chinese legal commentators explained in the copyright context:

[S]ignificant social and economic changes have taken place in China since the enactment of the 1990 Copyright Law. The fundamental economic structure of the country has been further transformed from a central planning system (“command economy”) into a socialist market economy. Based on predominant Chinese legal theory, law in general, and copyright law in particular, is part of a “superstructure” the content of which must reflect the ordering of its underlying economic base. From such perspective, law must be adjusted commensurate to its changing socio-economic context. Since the 1990 Copyright Law was enacted at a stage during which the influence of the “command” tradition was still sizeable, it unavoidably bears the hallmark of a command economy and therefore needs to be reconfigured to suit socialist market paradigms.<sup>93</sup>

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88. See *id.* at 70 (using the 1984 Chinese Patent Law to illustrate “socialist legality with Chinese characteristics”).

89. CLYDE PRESTOWITZ, THREE BILLION NEW CAPITALISTS: THE GREAT SHIFT OF WEALTH AND POWER TO THE EAST 27 (2005).

90. XIAN FA art. 15 (1982) (amended 2004) (P.R.C.) (emphasis added).

91. PRESTOWITZ, *supra* note 89, at 27.

92. XIAN FA art. 13 (1982) (amended 2004) (P.R.C.).

93. Feng & Huang, *supra* note 28, at 917.

Moreover, the notion of private profit became justifiable as the market developed. Indeed, “[w]hen experiments began in enterprises to replace profit quotas with taxation, many units saw exploiting patent rights as a good way to keep more profit for themselves, taking advantage of the new tax incentives for research in and exploitation of patented technology.”<sup>94</sup> At the turn of the millennium, the National People’s Congress took advantage of the millennium amendments to remove the outdated provisions and to align the Chinese intellectual property system with the socialist market economy.

### B. Domestic Rights Holders

Since the enactment of the 1990 Copyright Law, a large number of domestic copyright holders have emerged. To facilitate transactions among these rights holders, Article 8 of the revised copyright law provides that copyright holders “may authorize an organization for collective administration of copyright to exercise the copyright or any copyright-related right.”<sup>95</sup> This new provision expressly permits the creation of private collective copyright administration bodies, which, upon authorization, can act, litigate, or arbitrate on behalf of the copyright holders they represent.<sup>96</sup> The oft-cited example of these collective bodies is the Music Copyright Society of China. As one commentator described:

Until 2000, there was only one organization, the Music Copyright Society of China (MCSC) established on December 17, 1992, that was allowed to act on behalf of its collective members. The MCSC represents Chinese singers, composers, music adaptors, heirs, music publishers and recording companies of Chinese nationality. It currently has more than 2500 members. Since then, a few other collective bodies have also been established.<sup>97</sup>

In light of the growing number of private collective societies, one may wonder whether Article 8 is an example of the rent-seeking legislation widely criticized by Western commentators.<sup>98</sup> Indeed, the rent-seeking argument becomes even stronger when one takes into

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94. FENG, *supra* note 67, at 168.

95. Chinese Copyright Law, *supra* note 20, art. 8.

96. *See id.* (stipulating that “[a]fter authorization, the organization for collective administration of copyright may, in its own name, claim the right for the copyright owners and copyright-related right holders, and participate, as an interested party, in litigation or arbitration relating to the copyright or copyright-related right”).

97. SUN, *supra* note 23, at 63; *see also* XUE & ZHENG, *supra* note 24, at 32 (stating that MCSC “has successfully collected royalties for using background music from 68 Chinese hotels in May 2001”).

98. *See generally* JESSICA LITMAN, DIGITAL COPYRIGHT (2001) (discussing how the U.S. copyright law has expanded as a result of industry lobbying efforts).

account the lack of presence of foreign collective bodies in the country.<sup>99</sup> Nevertheless, regardless of whether Article 8 was the product of lobby efforts by MCSC and other private collective societies, one cannot deny that the political leverage of local copyright holders has increased substantially in the past decade.

### C. Modernization Efforts

In December 1996, members of the World Intellectual Property Organization (“WIPO”) adopted the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty to update international intellectual property norms in light of changes to the digital environment.<sup>100</sup> In strong resemblance to these two treaties, which entered into force in 2002,<sup>101</sup> Article 47(6) prohibits the

intentional[] circumventi[on] or destr[uction of] the technological measures taken by a right holder for protecting the copyright or copyright-related rights in his work, sound recording or video recording, without the permission of the copyright owner, or the owner of the copyright-related rights, unless otherwise provided in law or in administrative regulations.<sup>102</sup>

Article 47(7) also prohibits the “intentional[] delet[ion] or alter[ation of] the electronic right management information of a work, sound recording or video recording, without the permission of the copyright owner or the owner of a copyright-related right, unless otherwise provided in law or in administrative regulations.”<sup>103</sup> These provisions are neither mandated by the TRIPs Agreement nor have anything to do with the WTO, even if we broadly define China’s WTO commitments. Rather, they were included as part of China’s preparation to accede to the WIPO Internet Treaties.

Such preparation is important for two reasons. First, the Internet population has been growing exponentially in China. In the latest survey conducted by the China Internet Network Information Center (“CNNIC”), the country presently has an Internet population of more

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99. Compare SUN, *supra* note 23, at 63 (stating that it is unclear whether foreign copyright holders may form or join private collective societies in China), with XUE & ZHENG, *supra* note 24, at 32 (noting that “the International Copyright Treaties Implementing Rules recognize the function of foreign collective copyright management organizations”).

100. WIPO Copyright Treaty, Dec. 20, 1996, 36 I.L.M. 65; WIPO Performances and Phonograms Treaty, Dec. 20, 1996, 36 I.L.M. 76.

101. The WIPO Copyright Treaty entered into force on March 6, 2002, and the WIPO Performances and Phonograms Treaty entered into force on May 20, 2002.

102. Chinese Copyright Law, *supra* note 20, art. 47(6).

103. *Id.* art. 47(7).

than 110 million, behind only the United States.<sup>104</sup> As the use of the Internet and new communications technologies increases, disputes over digital copyright infringement will surface in courts. By including the online infringement provisions, the law provides certainty over the scope of rights protected on the Internet. Such certainty is important to both local and foreign Internet content providers and will greatly facilitate electronic commerce and broadband deployment.

Second, as demonstrated by the many bilateral and regional free trade agreements less developed countries have signed, the European Communities and the United States have been very aggressive in pushing for provisions that align local laws with the WIPO Internet Treaties.<sup>105</sup> Indeed, as the administration stated in the *2005 National Trade Estimate Report on Foreign Trade Barriers*, “[t]he United States considers the WIPO treaties to reflect many key international norms for providing copyright protection over the Internet . . . [and] China’s accession to the WIPO treaties is an increasingly important priority for the United States.”<sup>106</sup> If China did not include the provisions in the millennium amendments, it eventually would still have had to respond to the United States’ pressure. In that scenario, China would have to divert the scarce resources it could otherwise use on reforms or modernization projects that are not related to digital copyright issues. Moreover, the early adoption of the WIPO provisions sent a strong signal to the international community that the country was taking intellectual property obligations seriously.<sup>107</sup> This allowed China to earn goodwill despite its continuing struggle to improve intellectual property protection. Having in place a well-developed framework may also ensure that the terms of the debate are not framed solely by the United States.<sup>108</sup>

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104. See CHINA INTERNET NETWORK INFORMATION CENTER, 17TH STATISTICAL SURVEY REPORT ON THE INTERNET DEVELOPMENT IN CHINA, 4 (2005), <http://www.cnnic.net.cn/download/2006/17threport-en.pdf> (stating that China has an Internet population of more than 110 million).

105. See Peter K. Yu, *Currents and Crosscurrents in the International Intellectual Property Regime*, 38 LOY. L.A. L. REV. 323, 392-400 (2004) (discussing the growing use of bilateral and regional free trade agreements to strengthen intellectual property abroad).

106. 2005 NTE REPORT, *supra* note 69, at 96.

107. See *id.* at 95-96 (calling attention to the progress China has recently made in the area of intellectual property protection).

108. Cf. Jonathan Berger, *Advancing Public Health by Other Means: Using Competition Policy*, in NEGOTIATING HEALTH: INTELLECTUAL PROPERTY AND ACCESS TO MEDICINES 181, 196-97 (Pedro Roffe et al. eds., 2006) (explaining why less developed countries should invest resources in creating a competition regime before they are required to do so).

The final example concerns the protection of geographical indications, which has been fairly controversial in the international arena. Although the TRIPs Agreement requires protection of geographical indications,<sup>109</sup> it provides WTO member states with a great deal of freedom and latitude in implementing the provisions. Indeed, the regimes adopted by Europe and the United States are very different.<sup>110</sup> While European countries offer protection of geographical indications and appellations of origin, the United States protects geographical indications as mere collective or certification marks.

Most recently, the United States, along with Australia and other countries, challenged the European Communities before the WTO Dispute Settlement Body over the lack of protection of trademarks and geographical indications for agricultural products and foodstuffs.<sup>111</sup> As the United States claimed, the European Communities violated the TRIPs Agreement by failing to provide protection to pre-existing trademarks similar or identical to a geographical indication, by limiting the geographical indications the Communities will protect, and by limiting the access of nationals of other WTO member states to the procedures and protections provided under the Council Regulation (EEC) No. 2081/92 of 14 July 1992 on the Protection of Geographical Indications and Designations of Origin for Agricultural Products and Foodstuffs.<sup>112</sup> Although the Dispute Settlement Panel found that the European Communities failed to provide national treatment to the rights holders and products of other member states, it considered the substantive protection of geographical indications under the EC system consistent with the TRIPs Agreement.<sup>113</sup>

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109. See TRIPs Agreement, *supra* note 17, arts. 22-23 (requiring protection for geographical indications).

110. For an overview of protection of geographical indications and the discussions of the differences between the European Communities and the United States, see generally Lee Bendekgey & Caroline H. Mead, *International Protection of Appellations of Origin and Other Geographic Indications*, 82 TRADEMARK REP. 765 (1992); Albrecht Conrad, *The Protection of Geographical Indications in the TRIPs Agreement*, 86 TRADEMARK REP. 11 (1996); Paul Heald, *Trademarks and Geographic Indications: Exploring the Contours of the TRIPs Agreement*, 29 VAND. J. TRANS. L. 635 (1996).

111. Panel Report, *European Communities—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs* WT/DS174/R (Mar. 15, 2005) [hereinafter *Geographical Indications Panel Report*].

112. Council Regulation (EEC) No 2081/92 of 14 July 1992 on the Protection of Geographical Indications and Designations of Origin for Agricultural Products and Foodstuffs, 1992 O.J. (L 208) 9.

113. See *Geographical Indications Panel Report*, *supra* note 111.

The revised Chinese trademark law adopted the American model of geographical indications protection. Article 3 of the revised trademark law provides for the protection of geographical indications,<sup>114</sup> and Rule 6 of the Implementing Regulations of the Trademark Law states that a geographical indication can be registered as a certification or collective mark.<sup>115</sup> Given the controversy, one may wonder why China did not adopt the European model when it had an opportunity to do so. The answer to this question is simple: China was protecting geographical indications as certification marks before the amendments,<sup>116</sup> and the adoption of the U.S. model would allow the country to devote its modernization efforts to other more important areas. After all, “[f]rom the perspective of Chinese law reformers, the adoption of international norms is to serve domestic modernization needs and shall always be guided by Chinese social realities.”<sup>117</sup> In embracing the status quo, the amendments not only avoided the need to introduce a new form of protection that might create adverse effects on the local community, but they also left the battle with the European Communities over geographical indications to the United States and other countries. It is, therefore, no surprise that China joined Australia and the United States as a third party in *European Communities—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs*.<sup>118</sup>

#### D. Summary

In sum, the millennium amendments were enacted not merely to conform the Chinese intellectual property system to WTO standards, but also to meet the country’s rapidly-changing local conditions. Specifically, these conditions include the emergence of private property rights and local stakeholders, the increasing concerns about ambiguities over relationships with state-owned enterprises, and the government’s active push for economic modernization. Even the

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114. Chinese Trademark Law, *supra* note 20, art. 3.

115. Implementing Regulations of the Trademark Law of the People’s Republic of China, Rule 6, [http://www.saic.gov.cn/flfg/flfg\\_detail.asp?flfgid=1313](http://www.saic.gov.cn/flfg/flfg_detail.asp?flfgid=1313).

116. This is not a new rule, even though the old trademark law did not explicitly provide protection for geographical indications. As one commentator noted, “[b]efore [the] amendment, a geographical indication could be protected as a certification trademark in China.” Xie Lejun, *Protection of Appellations of Origin in China*, 1 CHINA PATENTS & TRADEMARKS 74, 74 (2001), *quoted in* Li, *The Wolf Has Come*, *supra* note 28, at 85; *see also* PETER GANEA & THOMAS PATTLOCH, *INTELLECTUAL PROPERTY LAW IN CHINA* 88 (2005) (observing that “[b]etween 1995 and May 2004, 110 geographical indications were registered and approved by the Trade Mark Office as certification marks or collective marks”).

117. Feng & Huang, *supra* note 28, at 921.

118. *Geographical Indications Panel Report*, *supra* note 111.



transparency and rule of law amendments were partly introduced in response to the Chinese leaders' changing attitude toward the rule of law, their eagerness to reduce corruption and local protectionism, and their determination to provide policy consistency and clarity as well as to streamline the judicial and administrative processes.

As Peter Feng noted, "[t]oday, more and more things are being done in the name of a rights discourse, as opposed to political privileges, moral duties and class status."<sup>119</sup> Thus, the transparency and rule of law amendments need to be viewed against this background, even though the WTO Agreements and China's accession agreements have posed new demands on the Chinese intellectual property system. Taking note of these background and local demands, it is a small wonder that Professor Feng summarized the recent legislative development as follows:

China's entry into the World Trade Organization in December 2001 spurred a legislative frenzy. All major intellectual property statutes were substantially revised and supplemented with new administrative regulations and judicial interpretations, for the sake of compliance with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) standards. But *more importantly*, the transparency and anti-corruption reforms in the practice and procedure of the People's Court, government units, cadre system and state-owned enterprises, in conjunction with the central leadership's official endorsement of a "rule of law" strategy of social control, all have worked to give law enforcement in general, and intellectual property in particular, new meanings and hence new challenges, quite unimaginable in the 1990s.<sup>120</sup>

## II. THE WTO DISPUTE

In February 2005, several trade groups, including the International Intellectual Property Alliance, the National Association of Manufacturers, and the U.S. Chamber of Commerce, recommended that the Bush administration take WTO action against China concerning its lack of enforcement of intellectual property rights.<sup>121</sup>

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119. FENG, *supra* note 67, at 6.

120. *Id.* at ix (emphasis added).

121. See, e.g., Letter from Eric H. Smith, President, IIPA, to Sybia Harrison, Special Assistant to the Section 301 Committee, Office of the U.S. Trade Representative (Feb. 9, 2005) [hereinafter IIPA Submission], [http://www.iipa.com/rbc/2005/CHINA%202005\\_Feb9\\_PRC\\_OCR\\_Submission.pdf](http://www.iipa.com/rbc/2005/CHINA%202005_Feb9_PRC_OCR_Submission.pdf) (recommending that "USTR immediately request consultations with China in the World Trade Organization, and that it place China on the Priority Watch List pending an out-of-cycle review to be concluded by July 31, at which time further appropriate multilateral and bilateral action, including the possible establishment of a dispute settlement panel in the WTO, will be

Such action was not available a decade ago, when China was still outside the WTO. At that time, the United States had to rely on threats of trade sanctions, threats of non-renewal of most favored nation status, and opposition to entry into the WTO to induce China to strengthen intellectual property protection. As I discussed in my earlier article, these threats were largely ineffective and had led to what I described as the “cycle of futility,” in which China and the United States threatened each other with trade wars, only to back down in the eleventh hour with a compromise that did not provide sustained improvements in intellectual property protection.<sup>122</sup> The threats also created resentment among the Chinese people while inflicting collateral damage on the United States’ longstanding interests in promoting free trade, human rights, and the rule of law.<sup>123</sup>

This time, however, China has joined the WTO, and the United States can no longer effectively threaten the country with unilateral trade sanctions. Under the TRIPs Agreement, all intellectual property disputes arising under the Agreement are required to be settled by the mandatory WTO dispute settlement process.<sup>124</sup> The WTO process prohibits a member state from taking retaliatory measures before it has exhausted all of the actions permissible under the rules.<sup>125</sup> Although unilateral sanctions are out of the question unless the United States withdraws from the WTO or unless the dispute falls outside the scope of the WTO agreements,<sup>126</sup> China’s membership

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determined”); NAT’L ASS’N OF MANUFACTURERS, NATIONAL ASSOCIATION OF MANUFACTURERS’ RECOMMENDATIONS ON SPECIAL 301 OUT-OF-CYCLE REVIEW OF CHINA (2005), [http://www.nam.org/s\\_nam/doc1.asp?CID=164&DID=233159](http://www.nam.org/s_nam/doc1.asp?CID=164&DID=233159) (recommending that the U.S. government, upon determining China’s designation as a Priority Foreign Country, “[b]egin preparations for filing a dispute settlement case before the World Trade Organization (WTO), contingent upon whether real results become apparent in terms of a pronounced decrease in counterfeiting in China”); U.S. CHAMBER OF COM., SUBMISSION FOR USTR’S SPECIAL 301 OUT-OF-CYCLE REVIEW ON CHINA’S IPR PROTECTION AND ENFORCEMENT (2005), [http://www.uschamber.com/international/regional/asia/050210ocr\\_submission.htm](http://www.uschamber.com/international/regional/asia/050210ocr_submission.htm) (recommending that “the Office of the United States Trade Representative . . . should immediately request consultations with China in the World Trade Organization”); Pat Choate, *The Pirate Kingdom*, N.Y. TIMES, May 12, 2005, at A27 (contending that “[t]he United States should bring an intellectual property case against China at the W.T.O”).

122. See Yu, *From Pirates to Partners*, *supra* note 11, at 140-48 (discussing the “cycle of futility”).

123. See *id.* at 174 (suggesting that the United States’ actions may have discredited the idea that individual rights are to be respected and protected through the legal process).

124. TRIPs Agreement, *supra* note 17, art. 64.

125. Panel Report, *United States—Sections 301-310 of the Trade Act of 1974*, WT/DS152/R (Dec. 22, 1999) [hereinafter *Section 301 Panel Report*].

126. See H.J.R. Res. 27, 109th Cong. (2005) (calling for the United States’ withdrawal from the WTO) (rejected by the House by a vote of 338-86); see also Editorial, *A Terrible Idea*, ORLANDO SENTINEL, June 6, 2005, at A26 (contending that Congress would be shortsighted to support a WTO withdrawal); see generally COBURN:

gives the United States a new process that includes consultations, negotiations, dispute settlement, and arbitration. To initiate this process, the United States needs to file a formal complaint with the WTO Dispute Settlement Body.

In April 2005, the Office of the United States Trade Representative (“USTR”) released the long-awaited results of its out-of-cycle review on China.<sup>127</sup> The report stated that “[t]he United States remains gravely concerned . . . that China has not resolved critical deficiencies in IPR protection and enforcement and, as a result, infringements remain at epidemic levels.”<sup>128</sup> Based on these concerns, the USTR elevated China to the Priority Watch List, marking the country’s first appearance on the list due to inadequate compliance with the TRIPs Agreement as well as other commitments made at the April 2004 meeting of the Joint Commission on Commerce and Trade.<sup>129</sup> The administration also expressed its intention to invoke the transparency provisions of the TRIPs Agreement to formally request information concerning selected intellectual property enforcement issues, including criminal and administrative penalties.<sup>130</sup>

To the disappointment of major trade groups and some legislators, the USTR decided against filing a formal complaint with the WTO Dispute Settlement Body following its out-of-cycle review. Had the administration done so, the complaint would have marked the second dispute the United States filed against China with the WTO Dispute Settlement Body.<sup>131</sup> Nevertheless, the USTR stated in its report its intention to “use WTO instruments *whenever appropriate* to address . . . concerns regarding the unacceptable levels of counterfeiting and piracy in China.”<sup>132</sup>

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*WTO Ignoring Intellectual Property Concerns*, NAT’L J.’S TECH. DAILY, July 18, 2005 (reporting Senator Coburn’s concern that the WTO process had made it difficult for the United States to protect intellectual property in China).

127. OFFICE OF THE USTR, OUT-OF-CYCLE REVIEW RESULTS (2005) [hereinafter 2005 OUT-OF-CYCLE REVIEW], [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2005/2005\\_Special\\_301/asset\\_upload\\_file835\\_7647.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/2005_Special_301/asset_upload_file835_7647.pdf).

128. *Id.* at 1.

129. *Id.* at 8.

130. *Id.*

131. The first dispute concerned a tax break favoring computer chips produced or designed in China. Request for Consultations by the United States, *China—Value-added Tax on Integrated Circuits*, WT/DS309/1 (July 14, 2004) [hereinafter *China—Value-added Tax on Integrated Circuits*]; see also Paul Blustein, *China Agrees to Resolve Dispute Over Tax Breaks*, WASH. POST, July 9, 2004, at E1 (reporting that China settled with the United States over its first complaint with the WTO); Terril Yue Jones & Bill Sing, *China, U.S. Settle WTO Chip Dispute*, L.A. TIMES, July 9, 2004, at C1 (reporting about the first WTO dispute between China and the United States).

132. 2005 OUT-OF-CYCLE REVIEW, *supra* note 127, at 8 (emphasis added).

Disappointed by the announcement, Senator Byron Dorgan introduced a resolution calling for the USTR to bring a formal complaint before the WTO regarding violations of intellectual property rights in China.<sup>133</sup> Meanwhile, U.S. business groups repeated their requests for the administration to take formal WTO action.<sup>134</sup> The USTR is currently reviewing its options and has been preparing its WTO dispute. In a recent congressional hearing, a USTR official stated that the WTO case against China is currently in its fact-finding phase.<sup>135</sup>

In October 2005, the United States invoked Article 63(3) of the TRIPs Agreement to formally request “clarifications regarding specific cases of IPR enforcement that China has identified for the years 2001 through 2004, and other relevant cases.”<sup>136</sup> The request was “made in conjunction with similar requests by Japan and Switzerland.”<sup>137</sup> Despite its request, the country has yet to file a complaint before the WTO. The USTR’s “wait-and-see” approach is understandable. Although the WTO dispute settlement process provides an effective tool to improve intellectual property protection in China, the general lack of enforcement of intellectual property rights does not present a strong case for the United States. If the United States pursues such a weak case before the WTO, there will be serious adverse implications for not only China and the United States, but also the international community at large. This Part explains why the United States should

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133. See S. Res. 142, 109th Cong. (2005) (calling for the USTR to bring a formal complaint before the WTO regarding violations of intellectual property rights in China).

134. See, e.g., Letter from Eric H. Smith, President, IIPA to Gloria Blue, Executive Secretary, Trade Policy Staff Committee (TPSC), Office of the U.S. Trade Representative (Sept. 9, 2005), <http://www.iipa.com/pdf/IIPA%20China%20TSPC%20WTO%20compliance%20Written%20Comments%20FINAL%2009092005.pdf> (reiterating its recommendation that “USTR immediately request consultations with China in the World Trade Organization”); Richard McGregor, *US Threatens to Take Film Piracy War with China to WTO*, FIN. TIMES, May 24, 2005, at 9 (reporting that the U.S. movie industry “threatened to push for action against China in the World Trade Organization as illegal DVD copies of the latest Star Wars movie went on sale on Beijing’s streets just a few days after its opening”).

135. See COBURN: *WTO Ignoring Intellectual Property Concerns*, *supra* note 126 (reporting that James Mendenhall, acting general counsel of the USTR, had stated that the WTO case “was still in the fact-finding phase” and that while there is “widespread anecdotal evidence” that Chinese companies are engaging in piracy, “knowing it intuitively is different from being able to prove it in dispute settlement”).

136. Letter from Peter F. Allgeier, United States Trade Representative, to H.E. Mr. Sun Zhenyu, Ambassador, Permanent Mission of the People’s Republic of China to the World Trade Organization (Oct. 25, 2005), [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2005/asset\\_upload\\_file115\\_8232.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/asset_upload_file115_8232.pdf).

137. OFFICE OF THE USTR, U.S.-CHINA TRADE RELATIONS: ENTERING A NEW PHASE OF GREATER ACCOUNTABILITY AND ENFORCEMENT—TOP-TO-BOTTOM REVIEW 14 (2006), [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2006/asset\\_upload\\_file921\\_8938.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2006/asset_upload_file921_8938.pdf).

not file a formal complaint with the WTO Dispute Settlement Body over inadequate enforcement of intellectual property rights in China.

#### A. *Lack of Definition*

Although the TRIPs Agreement stipulates that each WTO member state needs to provide effective intellectual property enforcement, it does not define what constitutes “effective” protection.<sup>138</sup> There is no doubt that a software piracy rate of ninety percent, as stated in a recent study by the Business Software Alliance, provides strong evidence of ineffective enforcement.<sup>139</sup> However, critics have challenged the accuracy of these figures. For example, Gary Shapiro, the president of the Consumer Electronics Association, described the figures as “[a]bsurd on its face” and “patently obscene.”<sup>140</sup> Indeed, because the numbers were supplied by a self-interested trade group, the WTO Dispute Settlement Panel is unlikely to take them at face value.<sup>141</sup>

Moreover, everything is relative. If the study by the Business Software Alliance was accurate—that is a very big if—we should not ignore the fact that the United States has a software piracy rate of twenty-one percent while other developed countries, like France, Italy, and Spain, have piracy rates that range from the mid-forties to the low-fifties.<sup>142</sup> A piracy rate of ninety percent for a country that did not have intellectual property laws twenty-five years ago is not as problematic as a rate of forty to fifty percent for a country that has had a well-established intellectual property system for more than two centuries.

In fact, as some commentators have suggested, one could interpret the word “effective” in light of the public policy goals set forth in the

138. See TRIPs Agreement, *supra* note 17, art. 41(1) (requiring that each WTO member state offer *effective* intellectual property enforcement, without providing a definition of what constitutes “effective” protection).

139. See BUS. SOFTWARE ALLIANCE & INT’L DATA CORP., SECOND ANNUAL BSA AND IDC GLOBAL SOFTWARE PIRACY STUDY (2005) [hereinafter GLOBAL SOFTWARE PIRACY STUDY], <http://www.bsa.org/globalstudy/upload/2005-Global-Study-English.pdf>.

140. *Software Piracy: BSA or Just BS?*, THE ECONOMIST, May 21, 2005, at 93.

141. See, e.g., ALFORD, *supra* note 87, at 129 n.13 (cautioning that loss figures supplied by the copyright industries and the U.S. government should not be taken at face value); COMM. ON INTELLECTUAL PROP. RIGHTS AND THE EMERGING INFO. INFRASTRUCTURE, NAT’L RES. COUNCIL, THE DIGITAL DILEMMA: INTELLECTUAL PROPERTY IN THE INFORMATION AGE 188 (2000) (discussing the difficulty in obtaining accurate estimates of the costs of illegal copying); Yu, *From Pirates to Partners*, *supra* note 11, at 175-76 (arguing that the copyright industries tend to overstate the extent of the piracy problem in China).

142. See GLOBAL SOFTWARE PIRACY STUDY, *supra* note 139, at 8 (reporting the software piracy rates of France, Italy, and Spain at forty-five percent, fifty percent, and forty-three percent, respectively).

TRIPs Agreement<sup>143</sup> or the technology transfer commitment as stated in article 66 of the Agreement.<sup>144</sup> As Paul Heald advocated:

[P]rotection should further “public policy objectives . . . including developmental and technological objectives . . . [and enable the least developed members] to create a sound and viable technological base.” It should also “contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare.” These objectives hardly dictate a narrow set of . . . options to developing countries. Moreover, one could interpret “effective” purely in terms of economic incentives: A member must provide a reward adequate to stimulate . . . successful research and development . . . .<sup>145</sup>

Under this interpretation, the amount of protection China should provide must be viewed in light of its domestic socio-economic conditions, technological needs, development goals, and public policy objectives. What is considered ineffective in the United States, therefore, may be considered effective in China.

### B. Lack of Evidence

Even if the Dispute Settlement Panel could come up with a piracy figure that can be used to determine ineffective enforcement, the United States might ultimately lack sufficient *non-anecdotal* evidence to show that China has failed its obligations.<sup>146</sup> As of this writing, U.S.

143. See TRIPs Agreement, *supra* note 17, arts. 7-8 (providing safeguards to protect the public interest); see also J.H. Reichman, *The TRIPs Agreement Comes of Age: Conflict or Cooperation with the Developing Countries*, 32 CASE W. RES. J. INT'L L. 441, 461 (2000) (suggesting that articles 7 and 8 of the TRIPs Agreement, taken together, may provide “a basis for seeking waivers to meet unforeseen conditions of hardship”).

144. See TRIPs Agreement, *supra* note 17, art. 66 (requiring developed countries to provide incentives for their businesses and institutions to help create “a sound and viable technological base” in least developed countries by promoting and encouraging transfer of technology).

145. Paul J. Heald, *Moving the Playing Field: Addressing Information Distortion and Asymmetry in the TRIPs Game*, 88 MINN. L. REV. 249, 286 (2003) [hereinafter Heald, *Moving the Playing Field*].

146. As Daniel Chow noted:

[In a complaint concerning China's failure to satisfy its TRIPs enforcement obligations, t]he burden of proof and persuasion will be upon the complaining party. Meeting these burdens will require the complaining party to gather evidence of China's failure to meet its obligations—a task that could take years given the complexity of the enforcement environment in China today—and would also require the party to prove its case before the WTO's Dispute Settlement Body. Not only will this be a long process requiring several years, but there is no guarantee that the party raising the dispute would succeed given that it now has all of the burdens of proof and going forward.

businesses have been reluctant to supply to the USTR piracy and counterfeiting data from China. Although the USTR had contacted industry groups and published a notice in the *Federal Register*,<sup>147</sup> it received only thirty-four submissions from the industry through the Section 301 submission procedures in 2005.<sup>148</sup> As former United States Trade Representative Robert Zoellick noted before he left office, the administration needed more information if it was to take formal WTO action against China.<sup>149</sup> In August 2005, the USTR published another notice on the *Federal Register* calling for information about China's compliance with the WTO commitments.<sup>150</sup>

Among all of the American businesses in China, small and midsize companies were particularly reluctant to disclose information. Their reactions are understandable. *Guanxi* (personal connections) and political capital are essential to doing business in China,<sup>151</sup> and these companies fear that the information they provide would result in political or business repercussions, such as permit delays, application denials, or bid rejections. Moreover, competition in China has become increasingly stiff; companies not only have to compete with local companies, but also with the many foreign companies now

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CHOW, *supra* note 64, at 253-54.

147. Identification of Countries Under Section 182 of the Trade Act of 1974: Request for Public Comment on Out-of-Cycle Review of the People's Republic of China, 69 Fed. Reg. 74561-01 (Dec. 14, 2004) (providing a notice that requested public comments in the USTR's section 301 review of countries).

148. 2005 OUT-OF-CYCLE REVIEW, *supra* note 127, at 2.

149. See *More Evidence Needed for China Piracy Case*, L.A. TIMES, Feb. 16, 2005, at C3 (reporting that "Outgoing U.S. Trade Representative Robert B. Zoellick . . . told the Senate Foreign Relations Committee that the United States had more homework to do before bringing a formal complaint at the WTO"); accord Sarah Lai Stirland, *Business Should Aid U.S. in Anti-piracy Efforts*, NAT'L J.'S TECH. DAILY, July 18, 2005 (quoting Brad Huther, the director of anti-counterfeiting and piracy of the U.S. Chamber of Commerce, as saying "[t]he data [provided to the USTR] has not been supplied in sufficient scope and depth to the United States Trade Representative in order for them to bring a case—that's something that the business community owes the USTR and we must do a better job at that"); see also Peter Drahos, *Securing the Future of Intellectual Property: Intellectual Property Owners and Their Nodally Coordinated Enforcement Pyramid*, 36 CASE W. RES. J. INT'L L. 53, 67 (2004) (noting that the U.S. trade enforcement process "is a highly information-intensive exercise").

150. Request for Comments and Notice of Public Hearing Concerning China's Compliance with WTO Commitments, 70 Fed. Reg. 44714 (Aug. 3, 2005) (providing another notice requesting for public comments concerning China's compliance with its WTO commitments).

151. See Yu, *From Pirates to Partners*, *supra* note 11, at 210 (discussing the importance of *guanxi* to conducting business in China); Gregory S. Kolton, Comment, *Copyright Law and the People's Courts in the People's Republic of China: A Review and Critique of China's Intellectual Property Courts*, 17 U. PA. J. INT'L ECON. L. 415, 451 (1996) (contending that "it may be difficult for foreign firms which plan to continue doing business in China to sue because doing so may wreck their '*guanxi*'—personal contacts or favors—that are integral for doing business in the PRC").

rushing to the Chinese market because of “China fever.”<sup>152</sup> As a former minister counselor at the U.S. embassy in Beijing noted, “[o]ur leaders may be right, but the Europeans get the contracts.”<sup>153</sup> It is, therefore, no surprise that these firms are concerned about taking political action that could hurt their bottom line.

To make the administration’s position more difficult, some companies disagree with the administration and the trade groups over whether the United States should take formal WTO action against China.<sup>154</sup> To them, such action would be counterproductive, and the resulting bilateral tension would hurt them the most, because they are more vulnerable to retaliation.<sup>155</sup> Trade groups and multinational corporations, by contrast, “could arouse enormous media attention or [obtain additional protection from local or even national leaders because their] investments contribute or would contribute so significantly to the economic development of a particular locality or the country as a whole.”<sup>156</sup>

Meanwhile, those who favor formal WTO action are confronted with what game theorists have called a classic “prisoner’s dilemma,” in

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152. See HAROLD CHEE WITH CHRIS WEST, MYTHS ABOUT DOING BUSINESS IN CHINA 30 (2004) (“The Chinese market is already highly competitive. As everyone wants to be in that market, a large majority of the global players are already here. And local Chinese competitors are not taking this lying down.”).

153. ODED SHENKAR, THE CHINESE CENTURY: THE RISING CHINESE ECONOMY AND ITS IMPACT ON THE GLOBAL ECONOMY, THE BALANCE OF POWER, AND YOUR JOB 109 (2005); see Yu, *From Pirates to Partners*, *supra* note 11, at 167-68 (“Today, goods produced in the United States are also produced in Europe and Japan. Because Europe and Japan do not impose similar demands on China, ‘the Chinese government will react to sanctions by becoming even more hostile to the United States and by switching from U.S. products to European and Japanese ones.’”).

154. See CHOW, *supra* note 64, at 245-46 (stating that “[m]any [multinational enterprises] . . . were reluctant to involve the USTR because of concerns that such involvement might lead to trade tensions and retaliation against their businesses by PRC authorities”); Veron Mei-Ying Hung, *China’s WTO Commitment on Independent Judicial Review: Impact on Legal and Political Reform*, 52 AM. J. COMP. L. 77, 85 (2004) (asserting that “[p]rivate enterprises are afraid of suing organs responsible for regulating commercial activities, such as departments of taxation as well as industry and commerce, because these departments can easily wage a war of attrition against any enterprise by, for instance, not granting administrative approvals needed for doing business in China”).

155. See Yu, *From Pirates to Partners*, *supra* note 11, at 167-68 (discussing how the Chinese might respond negatively by switching to European and Japanese products and services); see also Julia Chang Bloch, *Commercial Diplomacy*, in LIVING WITH CHINA: U.S./CHINA RELATIONS IN THE TWENTY-FIRST CENTURY 185, 206 (Ezra F. Vogel ed., 1997) (noting that “the Chinese government will react to sanctions by becoming even more hostile to the United States and by switching from U.S. products to European and Japanese ones”).

156. Hung, *supra* note 154, at 86; see also JAMES MCGREGOR, ONE BILLION CUSTOMERS: LESSONS FROM THE FRONT LINES OF DOING BUSINESS IN CHINA 149 (2005) (“If your business spans the entire nation, that means to the president, premier, and other politburo members and ministers. But don’t go there for anything less than a world-class dispute.”).



which players tend to cheat on others due to a lack of information about choices others have made.<sup>157</sup> While coordination by the USTR and the introduction of a confidential process may improve the quantity and quality of information available to each informant, some companies may consider it a win-win situation to stay out of the conflict and free ride on the efforts of their competitors and partners. If the United States prevails, they will be able to benefit from the WTO ruling. If the United States fails, however, they will still be able to maintain their *guanxi* and political connections. Even better, by demonstrating their loyalty throughout the process, they might be able to develop better *guanxi* and political connections, thereby ensuring further commercial success.

Some also would not see it as their business to think about the long-term implications of the United States' policy. As one venture capital manager responded when he was questioned about the long-term impact of the U.S. economy caused by outsourcing of research-and-developments to China and India, "[I]ook, I'm a loyal citizen but what happens to the United States is not my job. I have a fiduciary responsibility to my investors. The guys in Washington are supposed to be worrying about the United States."<sup>158</sup>

### C. *Difficulty with Enforcement*

Even if the United States were able to amass the needed evidence, the WTO process poses structural challenges to a general complaint about inadequate intellectual property enforcement. Virtually all of the existing WTO cases focus on the non-implementation of specific provisions, rather than a lack of general enforcement. (See Fig. 1.) The closest cases are those filed by the United States against Greece and the European Communities, in which the United States claimed that Greece violated Articles 41 and 61 of the TRIPs Agreement by not

157. The prisoner's dilemma is usually described as follows:

Two criminals are arrested, but the district attorney does not have enough evidence to convict either of them for serious charges unless one or both confess to the crime. The district attorney separates the two and makes the following offer to each: "If you confess and your partner does not, I will grant you immunity, and you will walk out free. However, if your partner squeals, and you don't, I'm going to throw the book at you. If neither of you confesses, then I'll have to settle for misdemeanor charges, which will get you each a brief prison term. If you both confess, I'll get you both on felony charges, but I'll argue for shorter sentences than if you do not confess and your partner does. Think about it and tell me what you want to do."

JAMES MORROW, *GAME THEORY FOR POLITICAL SCIENTISTS* 78 (1994). See generally ANATOL RAPOPORT & ALBERT CHAMMAH, *PRISONER'S DILEMMA* (1965) (providing a detailed discussion of the prisoner's dilemma).

158. PRESTOWITZ, *supra* note 89, at 148.

providing effective enforcement of intellectual property rights.<sup>159</sup> The cases were eventually settled.

FIGURE 1:

*WTO Intellectual Property Disputes (as of March, 1, 2006)*

	No.	Dispute (Complainant)	<i>TRIPs Provisions</i>
	DS28	Japan—Measures Concerning Sound Recordings (United States)	14
	DS36	Pakistan—Patent Protection for Pharmaceutical and Agricultural Chemical Products (United States)	27, 65 and 70
	DS37	Portugal—Patent Protection Under the Industrial Property Act (United States)	33, 65 and 70
	DS42	Japan—Measures Concerning Sound Recordings (European Communities)	14(6) and 70(2)
	DS50	India—Patent Protection for Pharmaceutical and Agricultural Chemical Products (United States)	27, 65 and 70
	DS79	India—Patent Protection for Pharmaceutical and Agricultural Chemical Products (European Communities)	70(8) and 70(9)
	DS82	Ireland—Measures Affecting the Grant of Copyright and Neighbouring Rights (United States)	9-14, 63, 65 and 70
E	DS83	Denmark—Measures Affecting the Enforcement of Intellectual Property Rights (United States)	50, 63 and 65
E	DS86	Sweden—Measures Affecting the Enforcement of Intellectual Property Rights (United States)	50, 63 and 65

159. Request for Consultations by the United States, *Greece—Enforcement of Intellectual Property Rights for Motion Pictures and Television Programs*, WT/DS125/1 (May 7, 1998); Request for Consultations by the United States, *European Communities—Enforcement of Intellectual Property Rights for Motion Pictures and Television Programs*, WT/DS124/1 (May 7, 1998).

	DS114	Canada—Patent Protection of Pharmaceutical Products (European Communities)	27(1), 28 and 33
	DS115	European Communities—Measures Affecting the Grant of Copyright and Neighbouring Rights (United States)	9-14, 63, 65 and 70
E	DS124	European Communities—Enforcement of Intellectual Property Rights for Motion Pictures and Television Programs (United States)	41 and 61
E	DS125	Greece—Enforcement of Intellectual Property Rights for Motion Pictures and Television Programs (United States)	41 and 61
	DS153	European Communities—Patent Protection for Pharmaceutical and Agricultural Chemical Products (Canada)	27(1)
	DS160	United States—Section 110(5) of the US Copyright Act (European Communities)	9(1)
	DS170	Canada—Term of Patent Protection (United States)	33, 65 and 70
	DS171	Argentina—Patent Protection for Pharmaceuticals and Test Data Protection for Agricultural Chemicals (United States)	27, 65 and 70
	DS174	EC—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs (United States)	3, 16, 24, 63 and 65
	DS176	United States—Section 211 Omnibus Appropriations Act of 1998 (European Communities)	2-4, 15-21, 41, 42 and 62
	DS186	United States—Section 337 of the Tariff Act of 1930 and Amendments Thereto (European Communities)	2, 3, 9, 27, 41, 42, 49, 50 and 51
	DS196	Argentina—Certain Measures on the Protection of Patents and Test Data (United States)	27, 28, 31, 34, 39, 50, 62, 65 and 70
	DS199	Brazil—Measures Affecting Patent	27 and 28

		Protection (United States)	
	DS224	United States—US Patents Code (Brazil)	27 and 28
	DS290	EC—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs (Australia)	1, 2, 3, 4, 16, 20, 22, 24, 41, 42, 63 and 65

E = Disputes on Enforcement of the TRIPs Agreement

Out of all the provisions of the TRIPs Agreement, Articles 41, 46, and 61 provide the strongest support for the United States' complaint. Article 41 requires WTO member states to "ensure that enforcement procedures as specified in [Part III of the TRIPs Agreement] are available under their law so as to permit *effective* action against any act of infringement of intellectual property rights covered by this Agreement . . . ."<sup>160</sup> Article 46 states an obligation for the judicial authorities to "create an *effective* deterrent to infringement."<sup>161</sup> Although Article 61 does not mention the word "effective,"<sup>162</sup> it requires member states to provide such remedies as "imprisonment and/or monetary fines *sufficient to provide a deterrent*, consistently with the level of penalties applied for crimes of a corresponding gravity."<sup>163</sup> This Article was one of the two used by the administration in its WTO dispute against Greece; it is apposite because policymakers and trade groups increasingly focus on not just effective enforcement, but on "effective, deterrent enforcement."<sup>164</sup>

Notwithstanding these provisions, challenging China on non-implementation grounds is likely to be very difficult, as most of the laws required under the TRIPs Agreement are already on the books. As Part I described, China made significant changes to its intellectual property regime in the wake of the WTO accession.<sup>165</sup> In the early 1990s, it also had made many substantial revisions to its intellectual property system in response to agreements signed with the United States.<sup>166</sup> Indeed, the USTR and many other U.S. officials had

160. TRIPs Agreement, *supra* note 17, art. 41(1) (emphasis added).

161. *Id.* art. 46 (emphasis added).

162. *Id.* art. 61.

163. *Id.* (emphasis added).

164. See, e.g., IIPA Submission, *supra* note 121, at 2 (discussing China's failure to provide "effective, deterrent enforcement" in fulfillment of their obligations under the TRIPs Agreement).

165. See discussion *supra* Part I (discussing the intellectual property reforms China undertook in the wake of its WTO accession).

166. See generally Yu, *From Pirates to Partners*, *supra* note 11 (discussing the U.S.-China

conceded that the problem with intellectual property protection in China is not with the laws, but with enforcement of these laws. As the *2005 National Trade Estimate Report on Foreign Trade Barriers* stated, “[w]hile China has made significant progress in its efforts to make its framework of laws, regulations and implementing rules WTO-consistent, serious problems remain, particularly with China’s enforcement of intellectual property rights.”<sup>167</sup>

However, should the United States go after China on non-enforcement grounds, the TRIPs Agreement might be on China’s side. Under Article 41(5) of the Agreement, a WTO member state is not required to devote more resources to intellectual property enforcement than other areas of law enforcement.<sup>168</sup> If China were able to show that their enforcement problems with piracy and counterfeiting were no more excessive than their problems with, say, tax collection (which are very serious),<sup>169</sup> China would be likely to prevail. After all, it is hard to imagine any country putting intellectual property protection ahead of tax collection. Nor does the WTO require it to do so. Moreover, as an attorney experienced with U.S.-China trade has noted:

Foreign investors should be warned . . . that China’s legal reforms have exceeded its enforcement abilities. Although China seems committed to its reforms, it still lacks the legal infrastructure to competently and efficiently handle intellectual property disputes. Moreover, Beijing’s ability to enforce its intellectual property regulations is seriously hampered by local resistance to change, particularly when local authorities sense that such change will take power out of their hands.<sup>170</sup>

To some extent, the intellectual property problems in China are not that different from those experienced in the United States and other developed countries, which have been struggling with massive

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agreements in the late 1980s and early 1990s and the resulting changes to the Chinese intellectual property system).

167. 2005 NTE REPORT, *supra* note 69, at 95.

168. TRIPs Agreement, *supra* note 17, art. 41(5).

169. See JOHN L. CHAN, CHINA STREETSMART: WHAT YOU MUST KNOW TO BE EFFECTIVE AND PROFITABLE IN CHINA 103 (2003) (noting that “in a developing economy like China, where tax rules are constantly changing, the loopholes are plenty and enforcement and interpretation vary from area to area”); see also PANITCHPAKDI & CLIFFORD, *supra* note 16, at 162-3 (discussing how local protectionism, or “warlordism,” has affected the development of the auto industry); John H. Jackson, *The Impact of China’s Accession on the WTO*, in CHINA AND THE WORLD TRADING SYSTEM, *supra* note 27, at 19, 27 [hereinafter Jackson, *Impact of China’s Accession*] (“China’s implementation of WTO obligations is partly an adjustment problem. It is also partly a problem of the central government’s power *vis-à-vis* local governments.”).

170. Kim Newby, *Doing Business in China: How the State of 1.3 Billion Can Tap the Nation of 1.3 Billion*, 19 MAINE BAR J. 238, 241 (2004).

unauthorized copying problems since the emergence of Napster and other file-sharing technologies.<sup>171</sup> In the past two years, the recording and movie industries have filed many rounds of lawsuits throughout the world against individuals distributing copyrighted works illegally via peer-to-peer networks.<sup>172</sup> The file-sharing problems are so important that courts around the world are now inundated with cases addressing secondary copyright liability.<sup>173</sup>

At some point, we need to recognize that intellectual property, due to its abstract nature, is generally treated differently from physical property. It does not matter whether it is in China or in the United States.<sup>174</sup> Even in major U.S. cities, it is not uncommon to notice street vendors selling pirated CDs and DVDs in the presence of police officers. Even though the officers are very unlikely to buy the fake products, the fact that they have no problems—either moral or legal—with the street vending activities has greatly weakened the U.S.’s moral claim.<sup>175</sup>

Moreover, many intellectual property rights holders have complained about the difficulty of convincing federal prosecutors to take piracy and counterfeiting cases seriously.<sup>176</sup> Some district attorneys’ offices, they maintain, just refuse to take those cases. From China’s standpoint, the lack of support from the U.S. authorities for

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171. For discussions of the massive unauthorized copying problem created by peer-to-peer file-sharing technology, see generally Peter K. Yu, *The Escalating Copyright Wars*, 32 HOFSTRA L. REV. 907 (2004); Peter K. Yu, *P2P and the Future of Private Copying*, 76 U. COLO. L. REV. 653 (2005) [hereinafter Yu, *P2P and the Future*].

172. See, e.g., Yu, *P2P and the Future*, *supra* note 171, at 658-76 (discussing the enforcement tactics used by the recording industry in 2003).

173. See, e.g., *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, 125 S. Ct. 2764, 2770 (2005) (holding that the distributors of peer-to-peer file-sharing technologies could be liable for copyright infringement committed by individuals using their products if they had “induced” their users to undertake infringing activities); *BMG Canada Inc. v. John Doe*, [2005] F.C.A. 193 (Can.) (addressing the issue of whether setting up the facilities to allow copying amounts to authorizing infringement); *Universal Music Austl. Pty Ltd v. Sharman License Holdings Ltd.* (2005) 65 I.P.R. 289 (Austl.) (holding the defendant liable for authorizing users to infringe on music copyrights and directing it to modify the software application to reduce infringement).

174. See Peter K. Yu, *Four Common Misconceptions About Copyright Piracy*, 26 LOY. L.A. INT’L & COMP. L. REV. 127, 131-40 (2003) (challenging the common misconceptions that copyright piracy is a cultural problem or the product of technological backwardness).

175. Arguably, state police officers could claim that it is not within their jurisdiction to combat the federal crimes of commercial piracy and counterfeiting. However, the scenes remain troubling and greatly weaken the moral strength of the United States’ arguments against China.

176. See, e.g., Remarks of Timothy P. Trainer, Esq., President, International Anti-Counterfeiting Coalition, Inc., at “Free Trade and Counterfeit Havens: A Cross-Industry Dialogue” Symposium at Michigan State University College of Law (Oct. 12, 2004).

prosecuting intellectual property crimes is particularly interesting. After all, the Chinese authorities have been heavily criticized for their reluctance to take action against the alleged infringers.

Compared to enforcement of domestic laws, enforcement of the TRIPs Agreement is even more difficult, as the issue has been further compounded by the political dynamics of the WTO negotiations. As Ruth Okediji aptly observed, the WTO member states can be seen as playing “a two-stage game” with respect to the negotiation and enforcement of the TRIPs Agreement.<sup>177</sup> Although commentators and policymakers in less developed countries have questioned the fairness of the Agreement, developed countries won the first-stage negotiation game by forming coalitions among themselves and by convincing their less developed counterparts to join them in an agreement that created minimum standards for intellectual property protection.<sup>178</sup> The strategies used to complete the first-stage game, however, have left developed countries with a much harder enforcement game to play—both among themselves and vis-à-vis less developed countries. As Professor Okediji noted:

Having accomplished the primary goal of binding developing countries to high standards of intellectual property protection, developed countries must now deal with the costs of “winning” the first stage game. These include constraints on sovereign discretion in the area of policy development, and battles over extant policy differences between the member states.<sup>179</sup>

As less developed countries become increasingly dissatisfied with the international intellectual property system and as they acquire more sophisticated knowledge about the international intellectual property regime, it is unlikely that developed countries will be able to win the enforcement game as easily as they won the negotiation game. Moreover, enforcement, by nature, is a more difficult game. That game is further complicated by the fact that some countries might

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177. Ruth L. Okediji, *Public Welfare and the Role of the WTO: Reconsidering the TRIPs Agreement*, 17 EMORY INT'L L. REV. 819, 823 (2003). Unlike Professor Okediji, this Author considers the game played by the WTO member states as a three-stage game, with stages in negotiation, implementation, and enforcement. Nevertheless, these differences will not affect the implications of Professor Okediji's important insight into the multi-stage game the TRIPs members have to play when they move from negotiation to enforcement.

178. There are many explanations why developed countries have agreed to join the TRIPs Agreement. See generally Yu, *Currents and Crosscurrents*, *supra* note 105, at 325-26 (discussing the various reasons why countries joined the TRIPs Agreement); Peter K. Yu, *TRIPs and Its Discontents*, 10 MARQ. INTELL. PROP. L. REV. 369, 371-79 (2005) (outlining the four different narratives commonly used to account for the establishment of the TRIPs Agreement).

179. Okediji, *supra* note 177, at 823.

have negotiated treaties knowing well in advance that those treaties would not be fully enforced due to domestic implementation constraints.<sup>180</sup> Indeed, as Andrew Mertha and Robert Pahre maintained, “a state with an implementation constraint [like China and other less developed countries] may make greater concessions knowing that they will not be implemented.”<sup>181</sup>

#### D. Adverse WTO Rulings

Although the United States initially dominated the WTO dispute settlement process and has scored major victories against less developed countries,<sup>182</sup> the WTO process does not guarantee victory for the United States—or, for that matter, any other developed countries. Indeed, when Congress deliberated the Uruguay Round Agreements Act, U.S. lawmakers expressed concern about the tension that adverse WTO rulings would pose to the country’s long-held constitutional principles and legal tradition.<sup>183</sup> A few days before Congress voted on the statute, Senate Robert Dole introduced a bill to establish a statutory commission to review adopted WTO panel reports adverse to the United States.<sup>184</sup> (The bill was eventually abandoned.<sup>185</sup>)

Even today, many policymakers take the position that the United States should withdraw from the WTO. Every five years, the Uruguay Round Agreements Act of 1994 requires the USTR to submit to Congress a report of “the effects of the WTO Agreement on the interests of the United States, the costs and benefits to the United States of its participation in the WTO, and the value of the continued participation of the United States in the WTO.”<sup>186</sup> After submission of the report, legislators can introduce a bill calling for the United

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180. See generally Andrew Mertha & Robert Pahre, *Patently Misleading: Partial Implementation and Bargaining Leverage in Sino-American Negotiations on Intellectual Property Rights*, 59 INT’L ORG. 695 (2005) (discussing the negotiation of treaties that parties know in advance will not be fully implemented). It is no coincidence that the authors illustrated this partial implementation process with the bilateral intellectual property agreements signed between China and the United States. *Id.*

181. *Id.* at 697.

182. See William J. Davey, *The WTO Dispute Settlement System: The First Ten Years*, 8 J. INT’L ECON. L. 17, 17 (2005) [hereinafter Davey, *WTO Dispute Settlement System*] (noting that “[t]he first half of [the first ten years’ operation of the WTO dispute settlement process]—from 1995 through 1999—was characterized by extensive use of the system by the United States initially, and later by the EU”).

183. S. 1438, 104th Cong., 1st Sess. (1995); see John H. Jackson, *The Great 1994 Sovereignty Debate: United States Acceptance and Implementation of the Uruguay Round Results*, 36 COLUM. J. TRANSNAT’L L. 157, 186-87 (1997) (discussing the proposed WTO Dispute Settlement Review Commission).

184. *Id.*

185. *Id.* at 187.

186. Uruguay Round Agreements Act of 1994, 19 U.S.C. § 3535 (2000).



States' withdrawal from the WTO. Following the USTR's most recent report, Representative Bernard Sanders (I-VT) introduced such a bill,<sup>187</sup> which the House subsequently rejected by a vote of 338-86.

The dissatisfaction of the WTO among policymakers is understandable. The WTO dispute settlement process does not benefit the United States all the time. Since the inception of the WTO, the United States has lost a number of major disputes. In December 1999, for example, the European Communities successfully challenged Sections 301-310 of the Trade Act of 1974 in *United States—Sections 301-310 of the Trade Act of 1974*.<sup>188</sup> In this dispute, the European Communities claimed that the strict time limits imposed by the U.S. statute did not provide sufficient time for a WTO member state to implement recommendations of the Dispute Settlement Body based on rules and procedures of the international trading body.<sup>189</sup> Although the Dispute Settlement Panel ultimately upheld the challenged sections, it confirmed that a WTO member state could not pursue retaliatory actions before it had exhausted all of the remedies permissible under the WTO rules.<sup>190</sup> In effect, the Panel limited the ability of the United States to impose unilateral trade sanctions without going through the WTO dispute settlement process.

A year later, the United States lost its dispute with the European Communities over Section 110(5) of the U.S. Copyright Act, which enables some restaurants and small establishments to play copyrighted music without compensating copyright holders.<sup>191</sup> In this dispute, the European Communities argued that the homestyle and business exemptions of the U.S. Copyright Act were in violation of the TRIPs Agreement.<sup>192</sup> The United States defended that the exemptions were valid under Article 13 of the Agreement, which allows member states to “confine limitations or exceptions to exclusive rights to certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.”<sup>193</sup> The Dispute Settlement Panel held for the European

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187. See H.J. Res. 27, 109th Cong. (2005).

188. *Section 301 Panel Report*, *supra* note 125.

189. *See id.*

190. *See id.*

191. Panel Report, *United States—Section 110(5) of the US Copyright Act*, WT/DS/160/R (June 15, 2000) [hereinafter *Section 110(5) Panel Report*]. For discussions of the dispute, see generally Graeme B. Dinwoodie, *The Development and Incorporation of International Norms in the Formation of Copyright Law*, 62 OHIO ST. L.J. 733 (2001); Laurence R. Helfer, *World Music on a U.S. Stage: A Berne/TRIPS and Economic Analysis of the Fairness in Music Licensing Act*, 80 B.U. L. REV. 93 (2000).

192. 17 U.S.C. § 110(5) (B) (2004).

193. TRIPs Agreement, *supra* note 17, art. 13.

Communities, maintaining that the business exemption was inconsistent with Articles 11*bis*(1)(iii) and 11(1)(ii) of the Berne Convention as incorporated into the TRIPs Agreement.<sup>194</sup> Following the panel decision, the European Communities and the United States pursued arbitration to determine the penalty award,<sup>195</sup> which the United States did not pay until more than a year later.<sup>196</sup>

Most recently, in *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, the tiny Caribbean islands of Antigua and Barbuda mounted a David-and-Goliath challenge against the United States over its federal and state prohibitions of Internet and telephone gambling.<sup>197</sup> The complainants argued that the restrictions were inconsistent with the market access provisions of the General Agreement on Trade in Services,<sup>198</sup> which allow for the supply of gambling and betting services on a cross-border basis, as well as the U.S. Schedule of Specific Commitments.<sup>199</sup> The United States counter-argued that WTO member states were entitled to maintain restrictions on Internet gambling, which fall within the scope of exceptions “necessary to protect public morals or to maintain public order.”<sup>200</sup> The Dispute Settlement Panel found for the complainants, maintaining that the U.S. gambling regulations were in violation of the WTO Agreements. On appeal, the Appellate Body partially reversed the panel decision, upholding some of the U.S. federal laws as permissible exceptions.<sup>201</sup> Nevertheless, the Appellate Body affirmed the panel decision that some of the U.S. laws were inconsistent with the market access commitments made by the United States during the Uruguay Round.<sup>202</sup>

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194. See Section 110(5) Panel Report, *supra* note 191.

195. See Recourse to Arbitration Under Article 25 of the DSU ¶ 5.1, *United States—Section 110(5) of the US Copyright Act*, WT/DS160/ARB25/1 (Nov. 9, 2001) (determining the award at \$1,219,900 per year).

196. “As part of the Wartime Supplemental Appropriations Act, signed into law on 16 April 2003, the US Congress approved the \$3.3 million appropriation for European music right holders; the sum was subsequently paid to the representative body of European right holders (GESAC).” *Fair Play?*, COPYRIGHT WORLD, July/Aug. 2004. Thanks to Professor Won-Mog Choi for pointing out the payment.

197. Panel Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R (Nov. 10, 2004) [hereinafter *Online Gambling Panel Report*].

198. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement, *supra* note 17, Annex 1B, art. XIV(a), 33 I.L.M. 1168 (1994).

199. See *Online Gambling Panel Report*, *supra* note 197.

200. See *id.*

201. Appellate Body Report, *United States—Measures Affecting the Cross-border Supply of Gambling and Betting Services*, WT/DS285/AB/R (Apr. 7, 2005).

202. See *id.*

There is no doubt that the United States and the European Communities have dominated the dispute settlement process in the first few years of the WTO's existence, especially when the disputes involved intellectual property and the TRIPs Agreement. (See fig. 2.) Indeed, many of the United States' losses came from its archrival, the European Communities. However, in recent years, less developed countries have had more frequent use of the WTO process.<sup>203</sup> If the WTO rules are on their side, even tiny Caribbean islands can prevail over a trading giant like the United States.<sup>204</sup> One can only imagine what it will be like when an emerging trading power like China decides to face-off with the United States.

FIGURE 2:

*Distribution of Parties in WTO Intellectual Property Disputes  
(as of March 1, 2006)*

Countries	Cases as Complainants	Cases as Respondents
United States	15	4
European Communities	6	5
Australia	1	0
Canada	1	2
Brazil	1	1
Argentina	0	2
India	0	2
Japan	0	2

203. See Request for Consultations by Brazil, *United States—US Patents Code*, WT/DS224/1 (Feb. 7, 2001) (challenging U.S. patent laws for violations of articles 27 and 28 of the TRIPs Agreement); see also Davey, *WTO Dispute Settlement System*, *supra* note 182, at 24 (noting that “the US and the EC no longer were as dominant as complainants in the system” and that “developing country use of the system increased dramatically” in the second half of the first decade of operation of the WTO dispute settlement process).

204. But see William J. Davey, *Dispute Settlement in GATT*, 11 *FORDHAM INT'L L.J.* 51, 90 (1987) [hereinafter Davey, *Dispute Settlement in GATT*] (questioning whether less developed countries will “have the diplomatic or economic muscle to ensure that the decision is implemented” even if they win their case, based on the United States' past refusal to implement successful GATT findings against the United States by smaller countries).

Denmark	0	1
Greece	0	1
Ireland	0	1
Pakistan	0	1
Portugal	0	1
Sweden	0	1

As in most WTO cases, it is unlikely that either China or the United States will win the entire case. Indeed, because of the customary length and detail in the WTO panel reports, both the winning and losing parties are likely to score some important points. As William Davey observed, “the US lost the Film case and the EC lost the Section 301 case and neither appealed, perhaps because in each case the losing party won some useful points.”<sup>205</sup> Thus, if the United States files a complaint against China in the WTO process, it has to be ready for China to score some major points even if it wins.

Obviously, this argument cuts both ways, as the converse is also true. Just as China would score some useful points should it lose a WTO case, the United States would do the same and, therefore, would be shielded from a complete disaster if it lost on a bad case. Nevertheless, from the standpoint of the United States and other developed countries, such a filing would be unwise and dangerous, because the points it scores might not compensate for the symbolic effect of losing the first WTO case against China. Such a loss would also have a devastating impact that could spill over into other areas of international trade as well as disputes involving other developed countries.

#### *E. Need for Guidance*

The WTO dispute settlement process, if used properly, will help the United States’ long-term interests in promoting free trade by providing China with the needed guidance as it makes transition to full compliance with WTO rules. As Long Yongtu, the chief negotiator for China’s entry into the WTO, worried, “[l]acking expertise and professionals qualified on international rules may make China[] . . . ‘a blind man riding a blind horse’ within the WTO.”<sup>206</sup>

205. Davey, *WTO Dispute Settlement System*, *supra* note 182, at 19-20.

206. Li, *The Wolf Has Come*, *supra* note 28, at 104 (quoting Vivien Pik-Kwan Chan, *Chinese Economists Fear Favored West May Threaten Sovereignty*, S. CHINA MORNING POST,

Well-conceived challenges before the WTO Dispute Settlement Body are, therefore, needed to provide guidance during this critical transitional period.

As I have discussed elsewhere, foreign pushes are sometimes needed to fuel China's intellectual property reforms.<sup>207</sup> Indeed, commentators, like noted China analyst Kenneth Lieberthal, have suggested that "the reformers in the government plan to use the WTO entry requirements to force the domestic reforms that they believe will make Chinese firms competitive internationally in the coming decades."<sup>208</sup> As a result, an adverse decision by a dispute settlement panel "may help respondent's government counteract domestic pressures if that government can honestly argue that condemnation by [the WTO] is likely and retaliation by trading partners is possible."<sup>209</sup>

In addition, an adverse WTO decision can help break up the local monopolies and entrenched piracy interests that are lobbying against legal reforms and greater competition within the country.<sup>210</sup> Thus, WTO challenges need to be strategically used to maximize the

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Nov. 13, 2001); see PANITCHPAKDI & CLIFFORD, *supra* note 16, at 153 (quoting Wang Fei, a judge in the High People's Court in Shanghai, as noting that they were "very confused by WTO rules").

207. See Peter K. Yu, *The Copyright Divide*, 25 CARDOZO L. REV. 331, 368 (2003) (noting that "foreign pushes were undoubtedly helpful in establishing the Chinese intellectual property system in the early 1990s"); Yu, *TRIPs and Its Discontents*, *supra* note 178, at 377 (noting that foreign pushes are sometimes needed because "countries . . . might not be able to implement policy changes that are in their best interests, at least of the country as a whole"); see also Edmund W. Kitch, *The Patent Policy of Developing Countries*, 13 UCLA PAC. BASIN L.J. 166, 178 (1994) (noting that "[o]utsiders can play a constructive role by insisting that the issues be addressed within a larger and principled framework" and thus prevent internal political forces from blocking the adoption of an optimal, long-run strategy); Robert P. Merges, *Battle of the Lateralisms: Intellectual Property and Trade*, 8 B.U. INT'L L.J. 239, 243-44 (1990) [hereinafter Merges, *Battle of the Lateralisms*] (observing that "representatives of the 'pirate' industries may have enough political clout to block the proposed changes" even though the changes might be in the best interests of a country as a whole).

208. Kenneth Lieberthal & Geoffrey Lieberthal, *The Great Transition*, in HARV. BUS. REV., *DOING BUSINESS IN CHINA* 1, 7 (2004); see also Richard Janda & Men Jing, *China's Great Leap of Faith: Telecommunications and Financial Services Commitments*, in CHINA AND THE LONG MARCH TO GLOBAL TRADE: THE ACCESSION OF CHINA TO THE WORLD TRADE ORGANIZATION 66, 67 (Sylvia Ostry et al. eds., 2003) (noting that "[t]he Chinese leadership obviously chose to use WTO entry not only to solidify existing reforms, but also as an engine for further and more dramatic reforms in the key financial services and telecommunications sectors") [hereinafter CHINA AND THE LONG MARCH]; WTO *Deal Is Major Victory for China's Zhu*, WALL ST. J., Nov. 16, 1999, at A21 ("WTO is the lever that the reformers need to open the system. You can't reform from above. You can't reform from below. So you reform from outside." (quoting Rick Baum, political scientist, University of California at San Diego)).

209. Davey, *Dispute Settlement in GATT*, *supra* note 204, at 74.

210. See PANITCHPAKDI & CLIFFORD, *supra* note 16, at 163-64 (discussing how domestic legal reforms accompanying China's accession to WTO may provide hopes for local partners in reducing local favoritism).

benefits created by China's WTO accession. If the right complaint is brought, the United States might even be able to enlist the support of local companies, which are equally concerned about the anticompetitive behavior of the monopolies and entrenched players.

Although the WTO has a broad coverage, some complaints are less well-suited than others for the WTO dispute settlement process. For example, the United States failed in its attempt to use the WTO process to open the Japanese market for American films.<sup>211</sup> If the United States is not careful in bringing these challenges, it might create a new "cycle of futility" similar to the one created in the early 1990s.<sup>212</sup> In this new cycle, the United States might threaten to take, or might actually take, formal WTO action on a weak WTO case on inadequate intellectual property enforcement, only to find unsustainable improvements in intellectual property protection in China.

This is particularly problematic, because a formal WTO complaint will strain the bilateral relationship between China and the United States, regardless of who wins at the end.<sup>213</sup> So far, the United States has filed only one complaint against China with the WTO Dispute Settlement Body, which has been quickly settled.<sup>214</sup> Likewise, China has been a co-complainant in only one dispute with the United States, which the latter lost despite its appeal to the Appellate Body.<sup>215</sup>

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211. See Panel Report, *Japan—Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R (Mar. 31, 1998) (finding that the United States had not demonstrated that the Japanese measures nullified or impaired the benefits accruing to the US within the meaning of the General Agreement on Tariffs and Trade); see also Davey, *WTO Dispute Settlement System*, *supra* note 182, at 28 (noting that "the experience in the Film case demonstrates that the WTO rules are not well suited to disciplining indirect and informal barriers to market access"); Jackson, *The Impact of China's Accession*, *supra* note 169, at 24 (observing that the effectiveness of the WTO dispute settlement system has created "a tendency to throw things at the dispute settlement system").

212. See Peter K. Yu, *Still Dissatisfied After All These Years: Intellectual Property, Post-WTO China, and the Avoidable Cycle of Futility*, 34 GA. J. INT'L & COMP. L. 143, 148-51 (2005) (discussing the new cycle of futility).

213. See ROBERT HUDEC, ADJUDICATION OF INTERNATIONAL TRADE DISPUTES 25-26 (1978) (discussing how the legalistic approach would promote conflict and contentiousness in an organization that sought to promote negotiated solutions); Davey, *Dispute Settlement in GATT*, *supra* note 204, at 70 (arguing that a legalistic approach may be counterproductive "because it poisons the atmosphere in which [diplomatic] contacts take place . . . [and because] economic relations between the contending parties may deteriorate generally as positions in the dispute harden and bad feelings spill over into other areas"); Peter K. Yu, *Toward a Nonzero-Sum Approach to Resolving Global Intellectual Property Disputes: What We Can Learn from Mediators, Business Strategists, and International Relations Theorists*, 70 U. CIN. L. REV. 569, 585 (2002) (noting that "as with all adversary processes, the dispute settlement procedure creates hostility between the disputing parties").

214. *China—Value-added Tax on Integrated Circuits*, *supra* note 131.

215. Appellate Body Report, *United States—Definitive Safeguard Measures on Imports of*

Because the countries had been adversaries in only two cases, “initiation of a complaint would be something of a slap in the face. The ignominy of a loss would also loom larger.”<sup>216</sup> Nevertheless, as more complaints are filed and as both parties have their share of wins and losses, the impact of a WTO dispute on bilateral relations will be greatly reduced, and the consequences of filing a risky case will be less severe.

#### F. SUMMARY

China spent fifteen years negotiating exhaustively for its entry to the WTO. While policymakers and commentators initially expressed reservations about China’s joining the international trading body, most of them, by now, have agreed that China’s WTO accession will benefit the international trading system in the long run. Indeed, some commentators have suggested that China will play a major role in the organization, given the fact that it joined the organization “[a]t a time when trade protectionism and unilateralism threaten to reemerge, and the demand for a more equitable distribution of the benefits of globalization is loud.”<sup>217</sup> Thus, it is important that the U.S. administration be patient and provide guidance as China learns to become a respectable member of the international trading body.

Although this Article argues against a complaint against the *general* lack of intellectual property enforcement, it does not argue against the use of the WTO dispute settlement process on all intellectual property matters. Indeed, it takes the position that WTO challenges will be particularly helpful in areas in which Chinese laws do not comply with the TRIPs Agreement,<sup>218</sup> as well as those in which the challenges are supported by prior WTO panel decisions. By contrast, WTO challenges will be the most risky in areas in which the laws meet the TRIPs requirements, but are not enforced effectively.<sup>219</sup> If the United States insists on pursuing the latter, it needs to understand the

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*Certain Steel Products*, WT/DS248/AB/R, WT/DS249/AB/R, WT/DS251/AB/R, WT/DS252/AB/R, WT/DS253/AB/R, WT/DS254/AB/R, WT/DS258/AB/R, WT/DS259/AB/R (Nov. 10, 2003). Other co-complainants were the European Communities, Japan, Korea, Switzerland, Norway, New Zealand, and Brazil.

216. Davey, *Dispute Settlement in GATT*, *supra* note 204, at 71.

217. Deborah Z. Cass et al., *China and the Reshaping of the World Trade Organization*, in CHINA AND THE WORLD TRADING SYSTEM, *supra* note 27, at 15.

218. For discussion of aspects of Chinese intellectual property laws that are inconsistent with the TRIPs Agreement, see *supra* note 66 and accompanying text.

219. See Angela Gregory, *Chinese Trademark Law and the TRIPs Agreement—Confucius Meets the WTO*, in CHINA AND THE WORLD TRADING SYSTEM, *supra* note 27, at 321, 342 (arguing that the WTO dispute settlement process may be more effective “in situations of deficiencies in substantive law rather than in cases in which the substantive law meets TRIPs requirements but enforcement is lacking”).

limitations and the potential consequences of its strategy. A weak case before the WTO will not only be unhelpful in liberating trade, but could potentially backfire on the entire international community. Pursuing such a case is worse than not bringing the case at all.

### III. THINKING OUTSIDE THE IP BOX

If the United States could not file a complaint with the WTO, one might wonder what other alternatives the country has in dealing with China's rampant piracy and counterfeiting problems. Elsewhere, I discussed four different areas in which policymakers and business executives should focus their remedial efforts: (1) educate the local people; (2) create local stakeholders; (3) strengthen laws and enforcement mechanisms; and (4) develop legitimate alternatives.<sup>220</sup> Even with these remedial efforts, foreign businesses are likely to suffer from rampant piracy and counterfeiting, at least in the short term. Thus, this Part explores the alternative protective measures intellectual property rights holders can take to protect their assets.

The two common approaches used to protect intellectual property in China are administrative enforcement and litigation. Although the former is cheaper, quicker, more flexible, and less antagonistic, the latter protects the rights holders from corruption and local protectionism<sup>221</sup> while allowing for damage compensation and pre-litigation remedies.<sup>222</sup> With the introduction of specialized courts with judges possessing intellectual property expertise since the 1990s,

220. See Yu, *The Copyright Divide*, *supra* note 207, at 428-37 (discussing four areas in which policymakers and business executives should focus remedial efforts to combat piracy and counterfeiting).

221. See, e.g., Thomas Lagerqvist & Mary L. Riley, *How to Protect Intellectual Property Rights in China*, in PROTECTING INTELLECTUAL PROPERTY RIGHTS IN CHINA 28 (Mary L. Riley ed., 1997) (maintaining that "[i]n China, administrative enforcement is occasionally seen as more cost effective than either civil or criminal proceedings against counterfeiters"); *id.* at 32 (asserting that Chinese judges are less likely than administrative agencies to bend to local pressure); Yiqiang Li, *Evaluation of the Sino-American Intellectual Property Agreements: A Judicial Approach to Solving the Local Protectionism Problem*, 10 COLUM. J. ASIAN L. 391, 414-15 (1996) (maintaining that "[t]he courts are . . . more powerful than administrative agencies"); Kolton, *supra* note 151, at 451 (noting that "it may be difficult for foreign firms which plan to continue doing business in China to sue because doing so may wreck their 'guanxi'—personal contacts or favors—that are integral for doing business in the PRC"); see also Susan Finder, *The Protection of Intellectual Property Rights Through the Courts*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 255 (Mark A. Cohen et al. eds., 1999) (discussing issues potential litigants in Chinese courts must be aware of when considering whether to seek enforcement of their intellectual property rights through the Chinese courts).

222. GANEA & PATTLOCH, *supra* note 116, at 290 (noting that "damage compensation and pre-litigation remedies are now only available from the courts, which will increase their importance tremendously over the long run").



courts in major cities have been greatly improved. As a result, rights holders in these cities have increasingly resorted to the use of courts. In 2002, for example, the total numbers of patent and trademark cases adjudicated were 2080 (an increase of 30.24% over 2001) and 707 (an increase of 46.68%), respectively.<sup>223</sup> Apart from these “dual enforcement” mechanisms, rights holders have also sought criminal enforcement,<sup>224</sup> enforcement through customs control,<sup>225</sup> and, more recently, litigation in the United States or other major markets outside of China.<sup>226</sup> Notwithstanding these approaches, businesses continue to struggle with inadequate intellectual property protection in China.

While this Part acknowledges the importance of legal reforms and development of the rule of law, it highlights the fact that the legal route is not the *only* way to protect intellectual assets. Instead, intellectual property protection is one of the *many* tools to achieve the ultimate goal of successfully doing business in China. Notwithstanding their importance, the other tools are seldom discussed by commentators.<sup>227</sup>

To fill this void, this Part presents six hypothetical case studies<sup>228</sup> in which intellectual property rights holders were able to protect their assets even when intellectual property laws were not effectively enforced. This Part draws insight from not only legal literature, but literature in business strategies and China studies. An understanding of the non-legal literature is particularly important, because the protection of intellectual assets is as much a business strategy as a legal issue. By presenting these case studies, this Part seeks to provide insight into both the causes of piracy and counterfeiting in China and

223. SUN, *supra* note 23, at 12.

224. *See id.* at 224-25 (discussing criminal enforcement).

225. *See id.* at 211-19 (discussing the use of border control measures provided by the Chinese Customs Law).

226. *See* Chiang Ling Li, *Enforcement of Intellectual Property Rights in China*, in CHINA'S PARTICIPATION IN THE WTO, *supra* note 68, at 241, 257 [hereinafter Li, *Enforcement of Intellectual Property Rights*] (citing an example of how a multinational electrical component company “was able to pursue patent infringement and product quality actions against the copied products outside of the PRC” because “most of the products of [the counterfeit] factories were exported outside of the PRC”); Emma Schwartz, *D.C. Firms View China with Caution*, LEGAL TIMES, Jan. 30, 2006, at 1 (discussing the growing use of U.S. courts by Chinese firms).

227. *See, e.g.*, LOKE KHOON TAN, PIRATES IN THE MIDDLE KINGDOM: THE ART OF TRADEMARK WAR 132-33 (2004) (discussing informal enforcement options for trademark holders); John Donaldson & Rebecca Weiner, *Swashbuckling the Pirates: A Communications-Based Approach to IPR Protection in China*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE, *supra* note 221, at 409 (discussing alternative, non-legal strategies for protection intellectual property in China); Lagerqvist & Riley, *supra* note 221, at 7 (same).

228. Although these case studies have been expanded and improvised, they are based on or inspired by real case studies.

the many barriers faced by local authorities in their enforcement of intellectual property laws.

Following the case studies, this Part questions whether the legalistic approach usually taken by foreign businesses is wise and productive in light of the country's historical aversion to courts and its significant emphasis on mediation.<sup>229</sup> As researchers from McKinsey & Company have found, "[m]any multinational companies in China are losing the battle to protect their intellectual property, largely because they rely too heavily on legal tactics and fail to factor IP properly into their strategic and operational decisions."<sup>230</sup> This Part concludes by exploring the differences between the Chinese and Western legal cultures and how these differences may have created different expectations between China and the United States over the role of the WTO dispute settlement process.

#### A. Competition

The first case study concerns a publisher of popular comic books.<sup>231</sup> Immediately after the books were published, unauthorized copies appeared in the market—some even before the publication of the originals. Although most consumers were able to distinguish between the genuine versions and the pirated copies, some of them failed to do so. Even for those who were able to notice the difference, some chose to purchase the pirated copies because they were much cheaper than the original products.

To deal with piracy, the publisher could sue the pirates in courts or seek administrative enforcement. Instead, it chose to compete directly against the pirates. To do so, it wrapped the comic books in hard-to-reproduce plastic, upgraded the quality of the graphics and paper, and included inexpensive educational prizes with each issue. Although its action no doubt increased production costs, the additional preparation made the comic books more expensive and difficult to copy. As the pirates turned to other, easier targets, subscriptions and profits increased.

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229. For discussions of the emphasis on mediation in China, see generally Jerome A. Cohen, *Chinese Mediation on the Eve of Modernization*, 54 CAL. L. REV. 1201 (1966); Stanley Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CAL. L. REV. 1284 (1967); Stanley B. Lubman, *Dispute Resolution in China After Deng Xiaoping: "Mao and Mediation" Revisited*, 11 COLUM. J. ASIAN L. 229 (1997).

230. Meagan C. Dietz et al., *Protecting Intellectual Property in China*, 3 MCKINSEY Q. 6, 6 (2005).

231. This case study was inspired by and improvised from Donaldson & Weiner, *supra* note 227, at 432.

This case study is instructive for a number of reasons. It highlights the fact that pirates and counterfeiters are rational businesspeople who seek profits and opportunities. As one commentator has pointed out, the total cost of piracy “includes the cost of producing and distributing the fakes and the cost of paying penalties, weighed against the embarrassment of being caught, the probability of being convicted, and the severity or inconvenience of any non-monetary penalties that are likely to be imposed.”<sup>232</sup> By increasing the cost of producing the fakes, the publisher successfully reduced the pirates’ profit margin while making its products a less attractive piracy target.

Foreign rights holders sometimes forget that they do not need to solve all of China’s piracy and counterfeiting problems. Unlike governments, they need not worry about the overall interests of businesses and nationals in the country. Instead, they merely need to focus on making themselves less attractive piracy targets. Surprisingly, despite the widespread reports of piracy and counterfeiting in China, many businesses expand into China without adequate planning and sophisticated protection strategies. As researchers from McKinsey & Company noted:

When we studied the Chinese operations of ten multinationals competing in IP-sensitive industries (including consumer electronics, medical equipment, pharmaceuticals, semiconductors, and software), we found that many executives think of protecting IP solely in legal terms—and *sometimes only after property has been stolen*. The most successful companies, however, take strategic and operational action to protect their IP *before* that happens, thus lowering their litigation costs and improving the odds that their IP will remain safe.<sup>233</sup>

Moreover, many foreign businesses ignore the differences in Chinese intellectual property laws, and some have the mistaken belief that what works in their home countries will work in China. For example, although registration is essential to trademark protection in China, many U.S. businesses fail to register their marks, hoping misguidedly that they can claim prior use without a registration.<sup>234</sup> Some also overlook the significance of registering the Chinese translations or transliterations of their marks. Pfizer, for example, did

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232. Lagerqvist & Riley, *supra* note 221, at 17.

233. Dietz et al., *supra* note 230, at 6 (emphasis added).

234. See Li, *Enforcement of Intellectual Property Rights*, *supra* note 226, at 257 (noting that “in many cases, multinational companies do not have their intellectual property rights registered or otherwise protected in the PRC”); see also CHAN, *supra* note 169, at 105 (noting the need to understand the difference between the Chinese and the U.S. trademark systems).

not register its Chinese name WEIGE, even though it registered the English name VIAGRA in China.<sup>235</sup> Even worse, as a Beijing-based attorney noted, “[c]ompanies—particularly those from the U.S.—are used to writing a cease and desist letter, which in China destroys your case. If you write a cease and desist letter you will never be able to get sufficient evidence through an investigation.”<sup>236</sup>

In fact, failure to take proactive measures may even result in underprotection of their products. A case in point is the recently settled three-year dispute between General Motors and Chery Automobile Company,<sup>237</sup> in which General Motors claimed that the Shanghai-based carmaker copied its Chevy Spark in designing the Chery QQ. Because General Motors did not have patents in China for its car designs, it sued Chery for trade secrets infringement.<sup>238</sup> Had the American automaker filed Chinese patents in the first place, as it did in its home market, it would have a much stronger claim<sup>239</sup> and might not even need the “assistance” of the Chinese government to secure an out-of-court settlement.<sup>240</sup>

Thus, proactive protective measures, like those taken by the comic book publisher in the present case study, are very important. By making products more expensive and difficult to copy, it sent a strong message to the pirates that they would make more money by choosing a more vulnerable target. Indeed, if its competitors had been less

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235. *Id.* For example, “[i]n . . . *Pfizer, Inc. v. Shenzhen Wanyong Information Network*, the court held that the plaintiff’s registered trademark, ‘VIAGRA,’ was not well known among Chinese people, though the plaintiff’s medicine was well known for its informal Chinese name ‘weige’ (which means ‘a strong brother’ in Chinese).” Hong Xue, *Domain Name Dispute Resolution in China: A Comprehensive Review*, 18 TEMP. INT’L & COMP. L.J. 1, 14-15 (2004).

236. *Secrets of Success in China*, MANAGING INTELL. PROP., Oct. 1, 2004, at 40 (quoting James Haynes, a partner of Beijing-based IP firm Tee & Howe).

237. See John Schmid, *Two Cars and One View: U.S. Taken for a Ride*, MILWAUKEE J. SENTINEL, Jan. 25, 2004, at 1A (reporting about the intellectual property dispute between General Motors and Chery Automobile Company over the copying of General Motors’ Chevy Spark).

238. See *Secrets of Success in China*, *supra* note 236, at 40.

239. See *id.* (quoting Wen Xikai, the deputy director general of the Law & Treaty Department of the State Intellectual Property Office, as suggesting that the trade secrets case is more difficult, because “evidence is very important” for that type of case).

240. *Intellectual Property Battle Between GM and Chery Reaches Settlement*, CHINA IP EXPRESS, Dec. 1, 2005, at [http://www.iprights.com/publications/chinaipexpress/ciex\\_268.asp](http://www.iprights.com/publications/chinaipexpress/ciex_268.asp) (reporting that “GM and Chery extended their appreciation to Chinese government for helping to resolve the dispute”). Although Chery agreed not to use the CHERY trademark in the United States, which is likely to be confusingly similar to General Motors’ CHEVY trademark, Malcolm Bricklin, Chery’s American partner, claimed that “Chery [was] not required to pay any compensation to GM under the settlement agreement . . . [and that] the agreement clears the way for a smoother introduction of the newly designed, Chinese-made, vehicles into the United States, starting in 2007.” *Id.*

protective of their products, the publisher's actions might have driven the pirates to its competitors, increasing their losses while reducing their ability to compete. In doing so, the publisher would have achieved what the Chinese describe as "killing two birds with one stone"—it fought both the pirates and the competitors by improving its products.

Some skeptics might question the wisdom of this competition strategy, citing the additional upgrading costs and the unethical nature of the pirates' behavior. However, the strategy makes good business sense. The improvement would reduce the losses caused by piracy, and such reduction, if planned carefully, would more than compensate for the higher production costs. In addition, by improving the products, the publisher would have rewarded its loyal customers for paying a higher price for the originals. It also would help convince customers that genuine products are worth the higher price they pay. In economic terms, the improvement would highlight the fact that pirated products are *imperfect* substitutes. Such signaling is important, because the Chinese eventually would demand products of higher quality as their living standards improve.

Although the facts on which this case study was based were taken from China, software companies around the world have widely used a similar competition strategy, offering such post-sale benefits as warranty service, replacement guarantees, free upgrades, and contests or giveaways. For example, Microsoft recently limited the downloading of updates to customers who have purchased genuine Microsoft products.<sup>241</sup> Many companies and industry groups also have actively highlighted the danger of using fake computer products, which often bring with them unwanted computer viruses and spyware. In doing so, these software companies force users to decide not only between genuine and pirated products, but also between products with additional benefits and those without.

### B. *Shaming*

The second case study deals with a baby food manufacturer that had been struggling with counterfeit products from local factories.<sup>242</sup> While the company went to the local authorities to seek administrative enforcement, it also took a proactive approach. When the authorities

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241. See Michelle Kessler, *Copy-protection Gear Sneaks into Products*, USA TODAY, Aug. 16, 2005, at 1B (reporting that Microsoft "now requires users to prove that they have an official version of its Windows operating system before downloading updates").

242. This case study was inspired by and improvised from Donaldson & Weiner, *supra* note 227, at 426.

raided the factories, the right holder brought reporters and a camera crew from the local media. In doing so, it not only exposed the counterfeiters and created evidence for the authorities, but also showed to the local community the shoddy quality of the fake products and the unsanitary facilities of the counterfeit factories. After a series of well-publicized raids, the counterfeiting problem was significantly reduced.

This case study is insightful for three reasons. First, unbeknownst to many Western business executives, public shaming is an effective strategy in China.<sup>243</sup> From the standpoint of Chinese psychology, public shaming causes the infringer to lose “face,” or *mianzi* in Chinese. As one commentator explained: “Face is about one’s self-respect and prestige and, crucially, about one’s standing in the group. It is an essentially public phenomenon, though it has powerful (albeit secondary) emotional consequences. The emotions are about dignity and dignity’s enemy, shame. This polarity runs deep in the lives of Chinese people. . . .”<sup>244</sup>

As far as legitimate businesses, as compared to nameless counterfeiters, are concerned, the embarrassment caused by the public apology will create a significant deterrent. It is, therefore, no surprise that Chinese companies have insisted on public apologies from the infringers. As an attorney noted:

When negotiating or litigating with a Chinese party, foreign companies often encounter a strong demand for making a public apology in addition to monetary compensation. Often it is quite difficult to persuade Chinese parties to withdraw a demand for a public apology, even at the expense of conceding more in damages.<sup>245</sup>

In light of this Chinese tradition, Chinese copyright law, unlike its Western counterparts, includes specifically the remedy of apology.<sup>246</sup> Both Articles 46 and 47 of the statute state that anyone who commits an act of copyright infringement “shall bear civil liability for such remedies as . . . making an apology.”<sup>247</sup> As Peter Feng explained:

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243. See MCGREGOR, *supra* note 156, at 10 (noting that “China is a shame-based society, very different from the guilt-based West”).

244. CHEE, *supra* note 152, at 48.

245. SUN, *supra* note 23, at 61.

246. This remedy is not available in trademark or patent law. Indeed, as Thomas Pattloch noted, “[r]ecent remarks by relevant officials within the Chinese People’s Courts indicate that future Interpretations by the [Supreme People’s Court] might exclude such a right for patent infringement proceedings.” GANEA & PATTLOCH, *supra* note 116, at 316.

247. Chinese Copyright Law, *supra* note 20, arts. 46, 47.

Traditionally, an apology to the injured party was seen as appropriate after a confession of guilt or wrongdoing, although it was more a moral duty than a legal requirement. Today, apologies are often ordered by the court in its judgments. They are published in newspapers and other media with a wide enough circulation to eliminate the “adverse effects” of the infringement. The content, as well as format and page, is court approved. If a wrongdoer or infringer fails to apologize as ordered, the court may draft and publish an apology instead and charge the expense to the wrongdoer.<sup>248</sup>

Alternatively, and more often these days, the court “will publish its verdict in the newspaper and charge the cost to the wrongdoer.”<sup>249</sup> To some extent, the request for an apology has lost its purpose of seeking a “voluntary admission of error and regret.”<sup>250</sup> Today, an apology is more like a shaming penalty or the alternative remedy of “eliminating the effects of the [infringing] act,” or both.<sup>251</sup> It is, therefore, no surprise that one commentator noted that the remedies of apology and elimination of adverse effects are often rendered together.<sup>252</sup> After all, “[a]pologies are one way to compensate for the adverse effects caused by the infringement.”<sup>253</sup>

Second, although the local authorities might not be concerned about counterfeiting, they might be very concerned about public health. While foreign businesses have widely criticized the Communist system for contributing to the country’s lack of respect for intellectual property rights, they often ignore the heavy emphasis the system has placed on the people’s well-being.<sup>254</sup> Because of this emphasis, the authorities may consider a violation of quality control or consumer protection laws a more serious offense than a violation of intellectual property laws. As a commentator has noted, “China has especially several laws and regulations containing statutory warranties of the quality of goods manufactured or sold in such cases. If the product copy is of inferior quality, selling it under a trade mark is an offense, *as is advertising it or selling it directly to a consumer.*”<sup>255</sup> Thus, if

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248. FENG, *supra* note 67, at 42-43.

249. *Id.* at 43.

250. *Id.*

251. See Chinese Copyright Law, *supra* note 20, arts. 46, 47 (providing for the remedy of “eliminating the effects of the [infringing] act”).

252. See SUN, *supra* note 23, at 60.

253. *Id.*

254. See TED C. FISHMAN, CHINA INC.: HOW THE RISE OF THE NEXT SUPERPOWER CHALLENGES AMERICA AND THE WORLD 170 (2005) (recalling that “[i]n an April 2004 scandal, 130 people were arrested for making phony infant formula using starch and water and contributing to the deaths of twelve children”).

255. Mary L. Riley, *Strategies for Enforcing Intellectual Property Rights in China*, in

the ultimate goal is to close down the counterfeit factories, it may be ill-advised for foreign rights holders to focus only on intellectual property protection, as such protection might not always be the most effective.

Non-intellectual property-based alternatives are particularly important when rights holders have to address piracy or counterfeiting problems outside of the major Chinese cities. In those places, government officials are often charged with many competing duties, including combating crimes, promoting public health and social welfare, and handling unemployment and other economic problems. Their reluctance to close down counterfeit factories, therefore, may be due to the fact that they are also charged with handling unemployment.<sup>256</sup> By closing down the counterfeit factories, they would have converted the counterfeiting problem into an unemployment problem. Even worse, from their standpoint, the unemployment problem is more serious, because it affects the local community while the counterfeiting problem concerns only foreign rights holders.

The baby food company in the present case study smartly turned this problem on its head. Instead of creating a new and more serious problem for the local authorities, it reminded the officials that their trouble would not go away even if they chose to ignore the counterfeit problem. After all, they still had to deal with the public health problem. More importantly, the public health problem would be more serious than the counterfeiting problem, because it concerned primarily the local community. As a result, the company created

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PROTECTING INTELLECTUAL PROPERTY RIGHTS IN CHINA, *supra* note 221, at 65, 70; *see* CHOW, *supra* note 64, at 206 (noting that “enforcement actions against counterfeiting can be brought with the Administration of Industry and Commerce (AIC) under the Trademark Law and its Implementing Rules or the Anti-Unfair Competition Law, or with the Technical Supervision Bureau (TSB) under the Consumer Protection Law or the Product Quality Law”); TAN, *supra* note 227, at 56 (stating that, “[a]s certain forms of trademark infringement may also be actionable under the [Product Quality Law], trademark owners may choose to take action through the local [Technical Supervision Bureaus]”); Li, *Enforcement of Intellectual Property Rights*, *supra* note 226, at 257 (citing an example of how a multinational electrical component company was “able to take actions against the offending factories based on product quality grounds” even though it “did not file patents in China to protect its inventions”).

256. *See* Simon P. Cheetham, *Protection of Intellectual Property Rights in Luxury Goods*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE, *supra* note 221, at 385 (stating that the local economies are concerned about “the employment, foreign exchange, and increased industrial development provided by counterfeiting factories”); Yu, *From Pirates to Partners*, *supra* note 11, at 210 (suggesting that the Chinese authorities would be concerned about “the unemployment problem that may result from the closure of pirate factories”).



incentives for the local authorities to close down the counterfeit factories.

Third, by bringing in the local media, the company was able to attract large-scale public attention, which in turn raised the concerns of local parents over the health and well-being of their children.<sup>257</sup> The publicized raids, therefore, created domestic pressure on the local authorities by drawing the local community to the side of the foreign right holder. By erasing the local-foreign divide, the raids also reduced the xenophobic sentiments that the local authorities might harbor toward foreign businesses. While some officials might still be concerned about the unemployment problem the factory closure would create, they were less likely to leave the factories open considering the wide local support the company had generated.

### C. Education

The third case study involves a joint venture created by a Western athletic shoe company and a local manufacturer and distributor.<sup>258</sup> In China, joint ventures are the typical business structures used by foreign companies to gain a foothold in the market. In some regulated industries, like the media industry, joint ventures were the only way to enter the country before China's WTO accession.<sup>259</sup> These joint ventures are important; they help increase market access, bridge cultural differences, overcome local protectionism, and utilize *guanxi* established by local partners.<sup>260</sup> There is one major problem, however: many local partners do not understand how intellectual property protection operates and why they need such protection. Such a lack of understanding not only creates confusion and disagreement, but also has led to the underprotection of the foreign partner's valuable assets.<sup>261</sup>

257. Nevertheless, the media strategy could backfire on the rights holders by "send[ing] the public into a state of panic" and turning away potential customers. Li, *Enforcement of Intellectual Property Rights*, *supra* note 226, at 252 (cautioning that "[i]n cases of baby formulae, pharmaceuticals, and foods and beverages, information about counterfeiting may send the public into a state of panic"). To avoid panic, the rights holders need to "focus on providing a positive message to the public about the genuine products." *Id.*

258. This case study was inspired by and improvised from Donaldson & Weiner, *supra* note 227, at 420.

259. See Peter K. Yu, *Piracy, Prejudice, and Perspectives: An Attempt to Use Shakespeare to Reconfigure the U.S.-China Intellectual Property Debate*, 19 B.U. INT'L L.J. 1, 31 (2001) [hereinafter Yu, *Piracy, Prejudice, and Perspectives*] (discussing the restrictions on wholly foreign-owned enterprises in the media sector).

260. See Yu, *From Pirates to Partners*, *supra* note 11, at 209-10 (listing the benefits of establishing joint ventures in China).

261. See Li, *The Wolf Has Come*, *supra* note 28, at 101 (discussing how "a Xiamen company registered the 'yinlu' trademark and allowed its U.S. joint venture partner to

In this case study, the Western partner asked the Chinese manufacturer for a portion of the joint venture profits to cover its design charges. The Chinese partner refused, believing that its Western partner was greedy and wanted to get more than its fair share of revenues. The negotiation dragged on for days without resolving the dispute. After a few days and some karaoke, the Western partner used a different approach. This time, it explained to the Chinese partner the importance of design charges and taught the local partner how to charge for design work itself. The Chinese partner was surprised; it did not know that it could charge separately for design work. After realizing that it could do so, it quickly agreed to the Western partner's request. It even mobilized to lobby the local regulators and the national legislature for the right to design fees.

This example is instructive for many reasons. A Chinese partner might refuse to protect products, not because it does not want to protect intellectual property, but because it does not understand why it needs to protect such assets, does not know that it could protect its own intellectual property rights, and has the misunderstanding that intellectual property is an unfair Western tool to eke out profits from hardworking Chinese people. By educating the Chinese partner, the Western shoemaker provided more information, alleviated its concern, and created goodwill. It also laid the much-needed groundwork for future partnerships that call for an allocation of intellectual property fees.

While education is always important, it is critically important in China, in which the cultural customs are different and intellectual property remains a new, and sometimes alien, concept. Consider the following additional facts about the shoemaker in the present case study.<sup>262</sup> Concerned about the limited disposable income local consumers have to buy the latest shoe models, the local manufacturer successfully convinced its Western partner to promote the company's lower-priced "classic" model, which was sold for only a third of the price of other more advanced models. Although this discount strategy had quadrupled sales and substantially enlarged the Chinese market in the first few years, the Western partner had its reservations. Fearing that the strategy would harm its image as a high-end technologically-advanced shoemaker, the company asked the local manufacturer to alter its strategy. Frustrated and confused, the manufacturer ignored

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use the mark freely").

262. The story with the additional facts was inspired by and improvised from the New Balance story described in Chew, *supra* note 19, at 56-59. For a journalistic account of the story, see Gabriel Kahn, *Factory Fight*, WALL ST. J., Dec. 19, 2002, at A1.

the company's request. Very soon, the discounted "classic" shoes appeared in Japan and Taiwan, as well as in Australia and Europe. The Western partner was enraged; it terminated the manufacturing and distribution agreement and sued the Chinese manufacturer for infringement of its intellectual property rights.

The added facts are actually taken from a true story concerning the shoemaker New Balance. In her analysis of the story, Pat Chew discussed how cultural factors may help explain the ineffectiveness of distribution and joint venture agreements in offering adequate intellectual property protection for Western companies. As she explains:

The contract may prohibit employees of the Chinese joint-venture partner from disclosing the American partner's proprietary information to "third parties." The Chinese, however, may define a "third party" differently than American business practices. In China's collectivist, socialist, relationship-oriented society, the notion of outsider status may be quite narrow. For instance, cultural traditions would likely indicate that family members, "extended-family" members, close friends, party members, and state-affiliated companies and their representatives are not outsiders, and hence, would not be considered as "third parties."<sup>263</sup>

While Professor Chew's observation is insightful and important, education could play a pro-active role in minimizing the potential misunderstanding between the two partners. For example, the shoe company could have either educated the local partner about what the term "third parties" meant even if it had failed to clearly define the term in the contract.<sup>264</sup> Even better, it could have introduced the licensing concept to the local manufacturer, explaining why licensees in Australia, Europe, Japan, and Taiwan should be treated as members of its "extended family." In doing so, the shoe company might have reduced the chance of creating confusion when it later asked the

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263. Chew, *supra* note 19, at 58-59.

264. Moreover, as one commentator noted:

When dealing with a partner who has control over a manufacturing or distribution process, it is critical that the main agreements directly address the extent to which subcontractors, agents, or other third parties are allowed access to a foreign party's intellectual property. Further, the agreements should stipulate that written arrangements must be in place before third parties are allowed to have such access. Signing substantive non-disclosure agreements with all parties holding access to key information further strengthens a foreign party's position in the event of unauthorized disclosure. Newby, *supra* note 170, at 242. Nevertheless, foreign businesses, and their lawyers, need to avoid long boilerplate contracts." *Id.* at 240; *see id.* (noting that "[c]ontract lawyers must be prepared to negotiate an acceptable compromise between a five-page model agreement issued by the Chinese authorities and a 60-page American-style agreement covering every imaginable indemnity, representation, and warranty").

manufacturer to abandon its discount strategy. Indeed, it might even have been able to convince the local partner to switch to a mutually-beneficial strategy that boosts sales in China without inflicting harm on the shoe company's other markets.

Despite the importance of education and the wide criticism of the ignorance of intellectual property rights in China, Western governments and businesses remain reluctant to invest in education. Their reluctance—and short-sightedness—is understandable. Education is a long-term strategy, and it does not bear fruit for many years. While American presidents are limited to two terms of four years, most CEOs of American companies do not last that long. As a result, neither the government nor the businesses have incentives to invest in long-term educational efforts.

Indeed, education is not the only under-focused area; intellectual property enforcement itself remains underserved. Despite the existence of rampant piracy and counterfeiting in China, many foreign businesses in China have allocated only limited budgets for intellectual property enforcement. As one attorney noted in frustration, “in the U.S., companies spend millions of dollars in patent litigation. But, they are not willing to allocate adequate budgets to China IP enforcement, instead hoping miracles will occur.”<sup>265</sup> If companies are unwilling to devote the resources needed for such a basic aspect of intellectual property management as enforcement, it is no surprise that they will be unwilling to devote resources to education.

Although the case study focuses mainly on education, it also provides insight into the stakeholder issue. As I advocated elsewhere, foreign governments and intellectual property rights holders need to help China develop local stakeholders.<sup>266</sup> A case in point is the China Software Alliance (“CSA”), the domestic software lobby formed in March 1995. As one commentator described the contributions of this lobby:

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265. SUN, *supra* note 23, at 16.

266. See Yu, *The Copyright Divide*, *supra* note 207, at 431-33 (discussing the need to develop local stakeholders as part of a four-part strategy to combat piracy and counterfeiting). One might question whether it would be wise for U.S. companies to help develop stakeholders in China, because these stakeholders will eventually become their competitors. While I am sympathetic to this concern, there are three possible responses. First, U.S. companies do not need to create stakeholders in areas that are key to their success. Instead, they can focus on areas that will complement their business or create synergy for them. Second, the benefits far outweigh the costs. Just as countries do not want to keep their trading partners weak and poor, companies should encourage the development of local stakeholders. Finally, there are only very limited alternatives, if any at all, and the development of stakeholders may perhaps be the best available alternative.

CSA successfully lobbied the NPC to emphasize the importance of having a separate software protection regulation, and also convinced the legislature “to add clauses that prohibit purchasers from trying to decipher software that makers had encrypted to prevent piracy.” To bolster enforcement, the CSA cooperated with the Business Software Alliance of the United States (BSA) to operate a national hotline for reporting piracy and wrote newspaper articles to promote public awareness of the enforcement of IP laws.<sup>267</sup>

By educating the local partner about the possibility of charging design fees in the first hypothetical, the shoe company did what the baby food company in the previous case study had done—it created a local stakeholder. As a result of its effort, the Western partner now has a local ally to depend on for lobbying its government. While foreign pressure is sometimes needed, domestic pressure is always effective. Indeed, by increasing domestic pressure on the local and national governments, the Western partner will be able to avoid any xenophobic sentiments created by its aggressive tactics.

Some policymakers and business executives have suggested that lawsuits and crackdowns are useful educational tools. In the context of file-sharing, for example, Cary Sherman, the president of the Recording Industry Association of America, took the position that “lawsuits are a very potent form of education.”<sup>268</sup> This unpopular approach, nevertheless, is risky and has been proven ineffective in China. There are too many reasons for crackdowns on piracy and counterfeiting activities by the Chinese authorities, and many Chinese view publicized raids with great skepticism. As Ted Fishman wrote:

The purposes behind the publicized raids are always obscure, and the Chinese who read about them are skeptical about taking the raids at face value. Are they the result of turf wars among the government fiefdoms that are themselves knee-deep in counterfeiting? Did the raided factories push the Party’s tolerance of violent and eroticized Western entertainment too far? Did they pirate a movie backed by the Chinese government? Or was that day’s demonstration of will just a show for a foreign trade group coming to China to—yet again—express its grave concerns over intellectual-property theft?<sup>269</sup>

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267. Li, *The Wolf Has Come*, *supra* note 28, at 100-01.

268. Benny Evangelista, *Online Music Finally Starts to Rock ‘n’ Roll*, SAN FRAN. CHRON., Dec. 29, 2003, at E1 (quoting Cary Sherman, president of the RIAA); *see also* Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 125 S. Ct. 2764, 2794 (2005) (Breyer, J., concurring) (noting that the RIAA’s lawsuits “have served as a teaching tool, making clear that much file sharing, if done without permission, is unlawful”).

269. FISHMAN, *supra* note 254, at 236.

Thus, although both education and enforcement actions will raise awareness of intellectual property rights among the Chinese, education is a more effective approach.

#### D. Co-optation

The fourth case study centers on a Western manufacturer whose production process required the purchase and installation of very expensive and complicated equipment. When the company realized that its product had been pirated in China, it hired a team of private investigators, who subsequently discovered the source of the piracy. Instead of going to court or seeking administrative enforcement, the company offered to purchase the pirate factory.<sup>270</sup> Because it was very expensive to build a similar factory from scratch, the pirates decided not to establish a new factory and accepted the company's offer instead. Gradually, the former pirates found the benefits of such a licensing arrangement; they not only earned income, but needed not fear factory closure, jail time, or financial damages. The story had a happy ending.

This case study invites a number of moral questions—in particular, whether and why one should reward the criminal acts of other people? However, moral questions aside, co-optation can be a very effective strategy, as it will take away the essential means of illegal reproduction. One should not forget that there are many causes of piracy. Sometimes, it is just greed; other times, however, it is poverty and desperation. As an administrative official reportedly recounted to his attorney friend, one poor street vendor committed suicide after his pirated goods had been taken away from him.<sup>271</sup> In the present case study, the manufacturer not only avoided this difficult problem by giving the factory workers an alternative means to earn an honest living, but it created the potential for converting a pirate to a future partner.

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270. See, e.g., CHEE, *supra* note 152, at 109 (using Cadence Design Systems as an example of Western firms that “managed to get the Chinese companies who [sic] pirated its products to become licence holding companies—who [sic] now have an interest in stopping the IP from spreading any further”); Clifford J. Shultz II & Bill Saporito, *Protecting Intellectual Property: Strategies and Recommendations to Deter Counterfeiting and Brand Piracy in Global Markets*, 31 COLUM. J. WORLD BUS. 18, 22-23 (1996) (arguing that companies consider co-opting pirates when more heavy-handed approaches would be costly); Eric M. Griffin, Note, *Stop Relying on Uncle Sam!—A Proactive Approach to Copyright Protection in the People's Republic of China*, 6 TEX. INTELL. PROP. L.J. 169, 188 (1998) (stating that co-optation through buy-outs or joint ventures may help alleviate the piracy problem).

271. See *Secrets of Success in China*, *supra* note 236 (remarks of Wen Xikai, Deputy Director General of the Law & Treaty Department, State Intellectual Property Office).

Moreover, the co-optation strategy would allow the Western manufacturer to create goodwill in the local community. As discussed earlier, government officials outside of major Chinese cities often have to deal with not only intellectual property problems, but also other seemingly more pressing problems, like unemployment and social welfare. Because of their dual, or multiple, capacity, they are often more receptive to a co-optation proposal than to one that requires factory closures. While the latter would create a more serious problem for the local community, the former would reduce *two* problems—piracy and social welfare.

Unfortunately, despite its benefits, the co-optation strategy does not work for every situation. Foreign businesses, therefore, need to carefully determine when and whether to utilize this strategy. When it is easy and inexpensive to re-establish the factory, co-optation would be similar to paying ransom to a kidnapper without asking him or her to release the hostage. In such a scenario, the pirates will continue selling their factories, only to set up another one in a different, often nearby place. The manufacturer will have to buy the same factories over and over again, while protection of its products will not improve.

Thus, if a company decides to use co-optation, it needs to conduct due diligence regarding the owner of the pirate factory, in particular whether it has the ability, or even plans, to set up another pirate factory.<sup>272</sup> To avoid misunderstanding and to preserve its future working relationship with the factory, it is ideal for the Western partner to explain the due diligence practice and its justification before pursuing the practice.<sup>273</sup> As an attorney experienced in U.S.-China transactions explained:

Due diligence is a concept distastefully alien to the Chinese. Chinese companies are not comfortable with outsiders inspecting books, records, and management practices. The Chinese view a detailed request for information as reflecting a lack of trust. Even Chinese companies with a history of foreign business interactions may be reluctant to share sensitive information with a foreign party. Sending a standard multi-page due diligence checklist to a Chinese

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272. CHOW, *supra* note 64, at 244 (observing that “[s]everal recent cases in China have highlighted the risks involved in dealing with unscrupulous third party contractors who have clandestine business relationships with counterfeiters at the same time that they are under contract to the [multinational enterprise]”); *see also* CHEE, *supra* note 152, at 109 (underscoring the importance of due diligence investigations in transactions in China).

273. *See* Newby, *supra* note 170, at 240 (suggesting that American companies explain both the scope of the review and the depth of the details required by the review).

target company is a common mistake made by American investors and one that can be a deal killer.<sup>274</sup>

### *E. Reinvestment*

The fifth case study focuses on a Western mobile phone company which understands the importance of reinvesting in the local community.<sup>275</sup> Every year, it invests a portion of its profits into the local community to promote cultural and educational benefits. Drawing on this case study, this Section proposes a new strategy in which foreign businesses ask for penalty awards in the form of cultural or educational benefits in the local community, or as contributions to a special patent fund that will be used by local inventors when they file patents both in China and abroad.<sup>276</sup>

One of the standard criticisms made by trade groups and rights holders is that penalties in China are too low to serve any deterrent effect. As the International Intellectual Property Alliance wrote in its recent report, “[i]ndustry is very concerned that the apparently grudging minor changes will not result in significantly more criminal cases with deterrent penalties and thus piracy levels will not be markedly affected.”<sup>277</sup> Indeed, foreign rights holders are known to joke about how they have “won the case but lost the money” in China.<sup>278</sup> Even worse for the rights holders, judgments in the country are not automatically enforced. Thus, the winning party often “has to spend extra time, effort and money to enforce the favourable judgment,” and their success will be greatly reduced when the

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274. *Id.*

275. See Doris Estelle Long, *China's IP Reforms Show Little Success*, IP WORLDWIDE, Nov.-Dec. 1998, at 5-6 [hereinafter Long, *China's IP Reforms*] (discussing Motorola's Project Hope, which “has contributed funds to assist in the construction of local primary schools throughout China”); see also CHAN, *supra* note 169, at 3 (noting that some foreign companies have “invested in university programmes, training projects and other large-scale infrastructure “to show they are a ‘good friend’ of China”); R. Michael Gadbaw & Timothy J. Richards, *Introduction* to INTELLECTUAL PROPERTY RIGHTS: GLOBAL CONSENSUS, GLOBAL CONFLICT? 1, 27 (R. Michael Gadbaw & Timothy J. Richards eds., 1988) [hereinafter GLOBAL CONSENSUS, GLOBAL CONFLICT?] (arguing for the investment of a portion of the benefits the United States would gain from the elimination of piracy).

276. See, e.g., *Secrets of Success in China*, *supra* note 236, at 43 (quoting Wen Xikai, the deputy director general of the Law & Treaty Department of the State Intellectual Property Office, as reporting that “[e]ach province or municipality has established a patent fund and if an enterprise has a good invention and wants to file abroad they can apply to the fund”).

277. IIPA Submission, *supra* note 121, at 2.

278. Ruay Lian Ho, *Compliance and Challenges Faced by the Chinese Patent System Under TRIPS*, 85 J. PAT. & TRADEMARK OFF. SOC'Y 504, 522 (2003).



financial circumstances of their adversaries change or when funds used to pay for the judgment have been absconded.<sup>279</sup>

The low penalty is understandable for at least three reasons, even if we ignore the statutory stipulation that damages in China can be calculated for a maximum period of only two years from the date of filing of the complaint, as compared to a maximum of six years in the United States.<sup>280</sup> First, the cost of living in China is much lower than that in the Western world. Thus, a calculation of the product value based on the price at which infringing product is sold in a market other than China, or at which the manufacturer priced it for the Chinese market, is far from reliable. Such a figure tends to distort decisions Chinese consumers make over the product.

Moreover, it is unlikely that there will be a uniform product price in China, given the drastically different living standards that exist in different parts of the country. Indeed, commentators have widely challenged the myth of a single market in China.<sup>281</sup> Because of the country's largeness, the cost of living in the East is far higher than that in the West, and the cost of living in the North may vary from that in the South. To some extent, one needs to recognize China as a "country of countries," rather than a homogenous one.<sup>282</sup>

Second, many judges are concerned that foreign rights holders will either take the penalty awards back to their home country, or to major cities in which their headquarters are located. Giving foreign rights holders large penalty awards, therefore, would drain the local community of its limited resources. Indeed, as a judge reasoned, foreign rights holders seem to be "more concerned with stopping future infringement than with receiving excessive compensation for past infringement."<sup>283</sup> It is, therefore, not unusual for judges to calculate compensation rewards based on the lower, rather than higher, estimates.

Third, heavy compensation seems morally wrong when the infringement involves a state-owned or collectively-owned enterprise. As Peter Feng explained:

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279. SUN, *supra* note 23, at 14.

280. See *id.* at 61 (discussing the difference between how damages are calculated in China and in the United States).

281. See, e.g., CHEE, *supra* note 152, at 3-9 (challenging the widely-held myth of a single market among businesspeople in China).

282. Cf. SHENKAR, *supra* note 153, at 134 (pointing out that "China's enormous labor reserve, with pay scales radically lower in the hinterland than on the coast and in urban areas . . . , creates the equivalent of a country within a country").

283. FENG, *supra* note 67, at 48.

[I]n the case of state-owned and collectively-owned enterprises, the cost of compensation is ultimately borne by the state or collective, which traditionally has the responsibility to take care of the employees' livelihood. As one judge commented concerning the compensation policy in a case of patent infringement before him, the innocent workers did no wrong; they expended labor and skill in producing the infringing products on which they earn their meager livelihood. The court should not shut its eyes to reality by depriving the workers of their only income.<sup>284</sup>

When Western businesses invest money they earned from the penalty awards back into the local community, the judges' second and third concerns are largely removed. Even better, from the perspective of foreign businesses, the reinvestment strategy would help them win the acceptance and goodwill of the local leaders and residents. Like the co-optation strategy, reinvesting in the local community also would help alleviate xenophobic sentiments among the Chinese people and their widespread skepticism toward Western institutions. In addition, such a strategy might also allow them to create local stakeholders by demonstrating to the local officials the benefits of adequate intellectual property protection and by including the local community in the benefits of the success of foreign businesses with major intellectual property assets.<sup>285</sup> The possibility of the local community losing these benefits might even motivate local authorities to pursue infringers that refuse to pay the penalty awards.

In recent years, local officials have learned this benefit indirectly. Because of the rampant piracy and counterfeiting problems, local and national governments as well as the private sector have allocated substantial resources for cracking down intellectual property infringement activities. As Daniel Chow has noted:

The authority to combat counterfeiting results in larger budgets and more staffing, power, and prestige. Raids are also potential revenue generating activities because the authorities confiscate cash, goods, machinery, and equipment, including cars, and then sell the confiscated goods at public auctions . . . . Government authorities also routinely ask companies to reimburse the cost of lodging where travel is required, the cost of hiring trucks to load and move confiscated goods, and the cost of storing the goods if a private

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284. *Id.*

285. See Long, *China's IP Reforms*, *supra* note 275, at 6 (using Motorola's Hope Project to illustrate how the reinvestment of funds to help pay for local primary schools in China allowed local officials to benefit from protection of Motorola's intellectual property rights).

warehouse needs to be rented. Some government authorities will also ask companies to pay case handling fees.<sup>286</sup>

Thus, the more actively the authorities crack down on piracy and counterfeiting activities, the bigger the budgetary income they will receive for the benefit of the community.

Finally, the reinvestment strategy would help generate much-needed funds for education and awareness efforts. As discussed above, the corporate budgets for intellectual property enforcement for many Western companies in China are limited, and business executives who are in charge of these budgets are often reluctant to spend them on long-term educational efforts. Reinvestment of these penalty awards, however, will serve to indirectly increase the enforcement budgets and allow the company to fund what they otherwise cannot afford or are unwilling to pay for. Moreover, because judges are likely to reduce the penalty awards if they are not reinvested back into the local community, foreign companies actually would be better served by allowing the awards to be paid in the form of educational or cultural benefits or as contributions to a special patent fund.

#### *F. Isolation*

The final case study concerns a manufacturer of state-of-the-art electronics products. Although the firm was eager to take advantage of the lower manufacturing and distribution costs and the potentially enormous future market in China, it was reluctant to relocate there, because of the fear that its patented technology would be stolen due to limited protection of intellectual property and inadequate enforcement of contract law in China. To protect its key technology, the manufacturer separated the high-technology components of its products from their low-technology counterparts, producing the former in the United States while manufacturing the latter and assembling the finished products in China. In doing so, the firm was not only able to resolve the dilemma, but also benefited from the growing Chinese market.

This case study is instructive for several reasons. First, it illustrates, again, the importance for foreign businesses in China of taking proactive measures to protect their intellectual assets. Despite increased globalization, physical distance and technological barriers remain effective defenses against piracy. In the present case study, for

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286. Daniel C.K. Chow, *Counterfeiting in the People's Republic of China*, 78 WASH. U. L.Q. 1, 31 (2000).

example, the electronics manufacturer, by isolating its key technologies, successfully protected against intellectual property infringement without pulling out of the Chinese market. If natural barriers are unavailable, companies can consider creating artificial barriers by carefully formulating a nondisclosure strategy to protect their trade secrets and critical know-how. In Edwin Mansfield's influential study on the relationship between intellectual property and foreign direct investment, a respondent was reported to have refrained from "implement[ing] manufacturing operations . . . that use [its] highest level of technology due to uncertainty over adequacy of trade secret protection."<sup>287</sup> Another respondent was reported to have minimized risks "by not disclosing critical catalyst or process know-how information to the licensee."<sup>288</sup>

Second, the present case study highlights the different factors a firm needs to consider when making decisions about why they want to relocate to China. As Paul Heald and Keith Maskus have noted, it is important to distinguish a business decision to relocate manufacturing and research facilities to a country from one that seeks to establish a market for its finished product.<sup>289</sup> While intellectual property is the main concern for the latter, it is of marginal importance to the former. Indeed, except for trade secret and contractual protection, there is empirically no strong correlation between other forms of intellectual property and a firm's decision to relocate manufacturing and research facilities.<sup>290</sup> Instead, a decision to relocate manufacturing facilities is likely to be determined by such "location advantages" as "market size and growth, local demand patterns, transport costs and distance from markets, low wage costs in relation to labor productivity, abundant natural resources, and trade protection that could

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287. EDWIN MANSFIELD, INTELLECTUAL PROPERTY PROTECTION, FOREIGN DIRECT INVESTMENT, AND TECHNOLOGY TRANSFER 27 (Int'l Fin. Corp. Discussion Paper No. 19, 1994).

288. *Id.* at 30.

289. See Heald, *Mowing the Playing Field*, *supra* note 145, at 258-60 (discussing the different concerns about intellectual property protection between the marketing division and the research and manufacturing division of a foreign company); see also Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 119-28 (1998) (discussing the various factors influencing foreign direct investment flows).

290. As Professor Heald noted:

Moving a research and development facility to a country without patent, trademark, or copyright law does not increase a firm's risk of damaging disclosures or increase its cost of doing business. In the absence of involuntary disclosure fears, MegaCorp's research and manufacturing divisions should be relatively indifferent to the level of patent, trademark, and copyright protection found in a developing country.

Heald, *Mowing the Playing Field*, *supra* note 145, at 259.

encourage ‘tariff-jumping’ investments.”<sup>291</sup> Likewise, a decision to relocate research and development facilities is likely to be affected by “the level of education and training of the local workforce, the condition of its financial sector, the health of its legal system, and the transparency of governmental procedures.”<sup>292</sup>

Third, the case study illustrates how the type of business structure a firm adopts may affect its ability to protect intellectual property. For example, wholly foreign-owned enterprises, or WFOEs, are in a better position to protect intellectual property than joint ventures.<sup>293</sup> Although foreign companies favored the formation of joint ventures in the past decade, they now have increasingly embraced WFOEs as the model business structure to enter the Chinese market, which has become increasingly open, thanks partly to the WTO accession. WFOEs not only enable foreign rights holders to maintain control over their businesses, but allow them to protect their key technologies by either isolating them or preventing comprises by mistakes made by local partners who are unconscious, or have limited awareness, of intellectual property protection.<sup>294</sup>

Moreover, technology transfer remains a major requirement for the establishment of joint ventures in China, especially when partnerships with state-owned enterprises are involved.<sup>295</sup> Those who are willing to transfer technology are also greatly rewarded.<sup>296</sup> As some experts have

291. Maskus, *supra* note 289, at 123.

292. Heald, *Moving the Playing Field*, *supra* note 145, at 259.

293. See CHAN, *supra* note 169, at 117 (recommending the establishment of WFOEs under “circumstances that involve companies with sensitive technologies and proprietary manufacturing processes to protect”); CHOW, *supra* note 64, at 179 (noting that “[a]dopting the WFOE form for a manufacturing facility, research and development center, and an investment holding company will help to reduce the risks of authorized access to proprietary rights by vesting greater control and security in the foreign investor”); MCGREGOR, *supra* note 156, at 92 (“Avoid joint ventures with government entities unless you have no choice. Then understand that this partnership is about China obtaining your technology, know-how, and capital while maintaining Chinese control.”).

294. See discussion Part III.C (discussing how local partners sometimes may be unconscious, or have limited awareness, of intellectual property protection).

295. See OFFICE OF STRATEGIC INDUS. & ECON. SEC., BUREAU OF EXP. ADMIN., U.S. DEP’T OF COMMERCE, US COMMERCIAL TECHNOLOGY TRANSFERS TO THE PEOPLE’S REPUBLIC OF CHINA i (1999) (assessing “the extent to which US commercial technology is being . . . ‘coerced’ from US companies engaged in normal business practices and joint ventures in China in exchange for access to China’s market”); see also Michael S. Lelyveld, *US Companies Are “Not Being Smart” in China*, J. COMMERCE, Mar. 1, 1999, at 1A (discussing the findings of the report).

296. As one commentator noted:

Those who were ready to transfer more cutting-edge technologies and to hand in the underlying capabilities were amply rewarded: They were granted permission to locate in the most desirable areas; given preferential governance and equity terms; provided with prolonged tax holidays and duty exemptions; and, perhaps most importantly, given preferential access or the

noted, China “require[s] trade ‘offsets’ in the form of technology transfers from foreign joint ventures . . . [and] has been frank about its need to acquire technology because of the prohibitive cost of trying to modernize from scratch.”<sup>297</sup> In addition, technology transfer through the establishment of joint ventures “was considered necessary for China to increase local added value, maintain local employment and speed up the process of industrialisation; and more important, through technological learning, to build up indigenous technological capabilities.”<sup>298</sup>

Chinese leaders have long held the belief that transfer of technology is more important than the cost and quality of service. For instance, when China was exploring opportunities to set up a joint production venture in the telecommunications field, it chose to team up with a Belgian firm, partly because of the firm’s willingness to transfer advanced switching technology.<sup>299</sup> This focus on technology transfer is understandable, considering the large-scale modernization efforts China is currently undertaking as well as the country’s long history of modernization reforms, which can be traced back to the Self-Strengthening Movement of the mid-nineteenth century.<sup>300</sup> Nevertheless, in the wake of the WTO accession, “China has agreed to eliminate technology transfer requirements and offsets as a condition for investment or importation immediately upon entry,”<sup>301</sup> and the Law on Wholly Foreign-Owned Enterprises and its implementing regulations were subsequently enacted to eliminate compulsory technology transfer.<sup>302</sup>

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promise of access to the much-coveted domestic market.

SHENKAR, *supra* note 153, at 67.

297. Lelyveld, *supra* note 295.

298. XIAOBAI SHEN, *THE CHINESE ROAD TO HIGH TECHNOLOGY: A STUDY OF TELECOMMUNICATIONS SWITCHING TECHNOLOGY IN THE ECONOMIC TRANSITION* 63 (1999).

299. *See id.* at 64 (noting that “[t]he most important factor was that BTM [Belgium-based Bell Technology Manufacturing Company] agreed to transfer technologies for component production, including the production technology of its custom LSI (large scale integrated circuit) chip” and that, at the time of the agreement, “no other supplier was prepared or able to offer the transfer of such advanced technology”); *see also id.* at 63-103 (discussing the establishment of Shanghai Bell as a Belgian-Chinese joint venture and the resulting transfer of System-12 technology).

300. *See Yu, Piracy, Prejudice, and Perspectives, supra* note 259, at 22-24 (2001) (discussing the self-strengthening movement and China’s modernization efforts).

301. PETER NOLAN, *CHINA AND THE GLOBAL ECONOMY: NATIONAL CHAMPIONS, INDUSTRIAL POLICY AND THE BIG BUSINESS REVOLUTION* 196 (2001).

302. As Shi Miaomiao, the deputy director general of the WTO Department in the Chinese Ministry of Commerce, stated:

In the investment area, China has revised the Law of People’s Republic of China on Chinese-Foreign Equity Joint Venture; and the Law on Wholly Foreign Owned Enterprises and their respective implementing regulations, including the elimination of the requirements on trade and foreign exchange

While the isolation strategy has many benefits, its effectiveness has been greatly undermined in recent years. As the literacy and education levels of the Chinese increase, a growing number are now entering colleges and universities. Indeed, recent studies have shown that China is facing an educational crisis due to the limited number of higher education institutions for the large number of qualified college-aged students.<sup>303</sup> Moreover, a growing number of Chinese, who have worked abroad and have acquired foreign training and experience, are now returning to China to work.<sup>304</sup> Because of the increasing relocation of research and development centers, China also benefits from an influx of expatriate workers.<sup>305</sup> As a result, technological capacity in China has greatly improved, and most products and technologies, except for very advanced ones, can now be reverse-engineered in China. Thus, even though it is still useful to isolate critical technology from China, the effectiveness of the strategy has been greatly reduced in regards to all but the very latest technologies.

#### G. Summary

The above case studies demonstrate how some foreign businesses were able to protect their intellectual assets even when intellectual property laws were ineffectively enforced. While these studies offer insight into possible alternative strategies to protect intellectual property in China, they also call into question the effectiveness and expediency of the legalistic approach usually taken by Western companies. To some extent, the discussion is reminiscent of the differences between the Chinese and Western legal cultures and of the

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balancing, local content, export performance and compulsory technology transfer.

Shi, *China's Participation in the Doha Negotiations*, *supra* note 68, at 31-32.

303. See CHEE, *supra* note 152, at 110-11 (noting the enormous talent pool in China); Bruce Einhorn, *No Peasant Left Behind*, BUS. WK., Aug. 22, 2005, at 102 (noting the "daunting" educational challenge in China).

304. See Bruce Einhorn & John Carey, *A New Lab Partner for the U.S.?*, BUS. WK., Aug. 22, 2005, at 116 (noting that "Beijing is . . . working hard to lure American-educated Chinese scientists back to the mainland"); see also SHENKAR, *supra* note 153, at 5 (noting that "Chinese students are now the largest contingent of foreign students in the United States" and that "returnees are bringing with them not only academic knowledge, but also . . . application know-how and business-related experience"). See *id.* at 75-77 for a brief discussion of the return of the "Turtles," or returnees. See DAVID ZWEIG, *INTERNATIONALIZING CHINA: DOMESTIC INTERESTS AND GLOBAL LINKAGES* 161-210 (2002), for a discussion of educational exchanges between China and the outside world.

305. See SHENKAR, *supra* note 153, at 66 (noting that "China was able to obtain technology on a scale unprecedented for a developing nation, culminating in the establishment of research and development (R&D) centers, the epitome of technology transfer").

millennia-old debate between the Confucianists and the Legalists in China.<sup>306</sup>

In this debate, the Confucianists questioned whether laws were needed or expedient.<sup>307</sup> As Confucius, the most influential Chinese philosopher of all time, explained in the *Analects*: “Govern the people by regulations, keep order among them by chastisements, and they will flee from you, and lose all self-respect. Govern them by moral force, keep order among them by ritual and they will keep their self-respect and come to you of their own accord.”<sup>308</sup> This concept of governance by moral norms can be traced back to the pre-Confucius period of Western Zhou (1122-771 B.C.), during which rituals or rites (*li*) were heavily emphasized.<sup>309</sup> These rites, broadly defined, covered a wide range of political, social, and familial relationships in society and informed people of their normative roles, responsibilities, and obligations to others.<sup>310</sup> In a Confucian society, people learn to adjust their views and demands to accommodate other people’s needs and desires, to avoid confrontation and conflict, and to preserve harmony.<sup>311</sup> Litigation, therefore, is unnecessary.

The Legalists, by contrast, believed it was impossible to teach people to be good. Laws and punishment (*fa*), therefore, were needed to maintain public order by instructing people what and what not to

306. For discussions of the debate between the Confucianists and the Legalists, see generally Chew, *supra* note 19, at 48-51; Yu, *Piracy, Prejudice, and Perspectives*, *supra* note 259, at 32-38.

307. See ALBERT H.Y. CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE’S REPUBLIC OF CHINA 9 (2d ed. 1998) (noting that the Confucianists “criticized the hedonistic pleasure-pain psychology relied on by the Legalists, which, [they] argued, would lead people to think only in terms of their self-interest and make them litigious, trying to manipulate the laws to suit their own interests”).

308. CONFUCIUS, THE ANALECTS OF CONFUCIUS bk. II, ¶ 3 (Arthur Waley trans., Vintage 1989) (500 B.C.).

309. See Yu, *Piracy, Prejudice, and Perspectives*, *supra* note 259, at 32-33 & n.207 (tracing the origins of the Chinese aversion to litigation).

310. See Glenn R. Butters, *Pirates, Dragons and U.S. Intellectual Property Rights in China: Problems and Prospects of Chinese Enforcement*, 38 ARIZ. L. REV. 1081, 1109-10 (1996) (discussing the concept of *li* and social roles).

311. See *id.* at 1109; see also Benjamin Schwartz, *On Attitudes Toward Law in China*, in GOVERNMENT UNDER LAW AND THE INDIVIDUAL (Milton Katz ed., 1957) (noting that “[t]he proper disposition with regard to one’s interests is the predisposition to yield rather than the predisposition to insist”), quoted in JEROME A. COHEN, THE CRIMINAL PROCESS IN THE PEOPLE’S REPUBLIC OF CHINA, 1949-1963: AN INTRODUCTION 62, 65 (1968); Alice Tay, *The Struggle for Law in China*, 21 U. BRIT. COLUM. L. REV. 561, 562 (1987) (noting that “Chinese tradition personalizes all claims, seeing them in the context of social human relationships”); Margaret Y.K. Woo, *Law and Discretion in Contemporary Chinese Courts*, in THE LIMITS OF THE RULE OF LAW IN CHINA 163, 168 (Karen G. Turner et al. eds., 2000) (noting that “[t]oday, litigation in the public courts is still viewed with disfavor in China, for it represents a breakdown in relationships that should be avoided. Ideally, broken relationships should be restored, but litigation makes restoration difficult”).



do.<sup>312</sup> Although Legalism was embraced in a very short period of time in the Qin dynasty (221-207 B.C.), it never dominated the Chinese society until very recently.<sup>313</sup> In fact, *fa* was often associated with the harsh, despotic, and unpopular Qin rule that united the country and centralized its bureaucracy.<sup>314</sup> As the Chinese would reason, “when government leans heavily on *fa* to reinforce its authority, it does so because it has no effective ability to rule by *li*.”<sup>315</sup> Thus, to many Chinese, laws should be used only as the last resort.<sup>316</sup>

Notwithstanding the unpopularity of *fa* and the overall reluctance of the Chinese to use a legal system, laws had not been abolished in imperial China. Rather, *li* and *fa* coexisted, and the Chinese emperors have used both concepts to govern the country.<sup>317</sup> Indeed, comprehensive legal codes were enacted in the Qin and Han dynasties, and the Tang Code, created after the Han dynasty, became the basis of the later codes of the Song, Yuan, Ming, and Qing dynasties.<sup>318</sup>

312. See Butterson, *supra* note 310, at 1110 (explaining that “*fa* is a penal concept; it is associated with punishment, serving to maintain public order through the threat of force and physical violence”).

313. See, e.g., CHEN, *supra* note 307, at 93 (“[T]he concept and doctrines of legality, unlike the precepts of Confucianism, had never occupied a central role in traditional imperial China. There has not existed a legal culture with elements like officials’ fidelity to law or citizens’ consciousness of their legal rights . . .”); FENG, *supra* note 67, at 11 (maintaining that “[t]here is . . . an entrenched Confucian-strategist tradition which regards formal law as an inefficient and cumbersome instrument for governance”). Even today, there are significant differences between the rule of law model Western countries projected on to China and the rule of law model embraced by Chinese leaders. See generally Randall Peerenboom, *Let One Hundred Flowers Bloom, One Hundred Schools Contend: Debating Rule of Law in China*, 23 MICH. J. INT’L L. 471, 486-510 (2002) (discussing the different rule of law models).

314. See Yu, *Piracy, Prejudice, and Perspectives*, *supra* note 259, at 34 (noting that *fa* was the dominant Chinese ideology in the Qin dynasty); Butterson, *supra* note 310, at 1108 (same). See generally GRAY L. DORSEY, JURISCLTURE: CHINA 125-30 (1993) (discussing Legalism in the State of Qin).

315. Butterson, *supra* note 310, at 1110.

316. See, e.g., ALFORD, *supra* note 87, at 10 (noting that “[p]ublic, positive law was meant to buttress, rather than supersede, the more desirable means of guiding society and was to be resorted to only when these other means failed to elicit appropriate behavior”); CHEN, *supra* note 307, at 11 (maintaining that *fa* “is to be employed as a last resort to maintain social order when *li* has failed to do so”); Jeffrey W. Berkman, *Intellectual Property Rights in the P.R.C.: Impediments to Protection and the Need for the Rule of Law*, 15 UCLA PAC. BASIN L.J. 1, 32 n.144 (1996) (explaining that Confucianism “saw law as an instrument of last resort necessary to punish those who could not follow the normative ideal of social harmony arising from the many social relationships within society”); Yu, *Piracy, Prejudice, and Perspectives*, *supra* note 259, at 34 (noting that “[t]o the Chinese, *fa* should always be employed as the last resort”).

317. See CHEN, *supra* note 307, at 11 (noting that “[t]here was thus a coexistence of both *li* and *fa* in traditional China” and that “[a]ll the dynastic empires subsequent to the Qin dynasty continued to develop codes of law and legal institutions”).

318. See *id.* at 12. The Tang Code remains the oldest surviving code in the country. *Id.*

While the debate between the Confucianists and the Legalists is interesting from a philosophical standpoint, it is also relevant to our discussion. This debate not only provides insight into questions like whether China will have the rule of law in the near future or whether the tens of thousands of Chinese laws and regulations will be eventually enforced,<sup>319</sup> but also broader questions concerning the nature of the WTO dispute settlement process and China's perception of that process.

One might recall the "general disagreement [before the establishment of the WTO] among GATT members over whether the principal role of GATT dispute settlement panels should be to render judicial-like decisions or to promote negotiated settlements through conciliation,"<sup>320</sup> which commentators attributed to the differences between Japan and the United States over their domestic dispute settlement traditions. As William Davey suggested, "the United States is a more litigious society than Japan, which places a high premium on consensus."<sup>321</sup>

The GATT debate was later extended to the WTO context, raising questions about whether the legalistic, rule-oriented approach of the dispute settlement process would be more effective and preferable to an alternative approach focusing on negotiation and conciliation.<sup>322</sup> Although commentators have widely credited the Uruguay Round for embracing the rule-based approach in establishing the mandatory dispute settlement process,<sup>323</sup> recent behavior of developed country

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319. See Chew, *supra* note 19, at 62 (suggesting that the debate between Confucianism and Legalism will raise questions about the prospects of rule of law in China).

320. Davey, *Dispute Settlement in GATT*, *supra* note 204, at 57. As Professor Davey described the two conflicting viewpoints:

[T]he legalistic view is that the General Agreement is a code of conduct and embodies a balance of concessions. If a contracting party violates the code and tips the balance, it is appropriate to label that party as a violator and to put pressure on it to conform its conduct to the code, if necessary by threatening some form of retaliation. On the other hand, the antilegalistic position is that the General Agreement is not a code of conduct per se, but more of a commitment by the contracting parties to deal in good faith with each other in trade matters so as to work out a mutually acceptable solution to any disagreement. The United States is generally perceived to support the legalistic position, while the EC and Japan are considered supporters of the antilegalistic view.

*Id.* at 66.

321. *Id.* at 67.

322. See generally *id.* at 65-81 (discussing the philosophical debate about whether a legalistic, rule-oriented approach of the dispute settlement would be more effective and preferable to one that focuses on negotiation and conciliation).

323. See, e.g., Rochelle Cooper Dreyfuss & Andreas F. Lowenfeld, *Two Achievements of the Uruguay Round: Putting TRIPS and Dispute Settlement Together*, 37 VA. J. INT'L L. 275, 277 (1997) (describing the process as having a "complex system of enforcement,

members in the WTO process, in particular the United States, have called into question whether the dispute settlement process is a rule-based system with mechanisms for negotiation and consensus building or a negotiation/consensus-based process backed by default rules.<sup>324</sup> After all, article IV of the Marrakesh Agreement Establishing the World Trade Organization has emphasized “the special character of the WTO, which is both a legally binding intergovernmental treaty of rights and obligations among its Members and a forum for negotiations.”<sup>325</sup>

A case in point is the incompliance of section 110(5) of the United States Copyright Act with the Berne Convention as incorporated into the TRIPs Agreement. Even after the Dispute Settlement Panel had found the United States in violation of the TRIPs Agreement in *United States—Section 110(5) of the US Copyright Act*, the United States refused to revise its copyright law.<sup>326</sup> If this trend continues—and, worse, if countries like China follow the United States’ lead—one has to wonder how effective the rule-based dispute settlement approach will be in maintaining worldwide protection of intellectual property rights, whether the legalistic approach makes sense in the international system that lacks an effective supranational enforcement mechanism,<sup>327</sup> and whether the dispute settlement process will offer the same level of protection to less developed countries as it does to their developed counterparts.<sup>328</sup> If the WTO dispute settlement

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complete with fairly short deadlines and provision for retaliation, in case a member state does not comply with a decision”).

324. Although commentators have focused on the dispute settlement aspects of the WTO process, the process also includes mechanisms for negotiation and conciliations. Under the procedure, a WTO member state can initiate consultations with another member state that allegedly has breached obligations under the treaty. Understanding on Rules and Procedures Governing the Settlement of Disputes, art. 4, Dec. 15, 1993, 33 I.L.M. 112, 116. If consultations fail, the parties may pursue good offices, conciliation, or mediation within the WTO. *Id.* art. 5.

325. Marrakesh Agreement, *supra* note 17.

326. See Status Report by the United States, *United States—Section 110(5) of the US Copyright Act*, WT/DS160/24/Add.9 (Aug. 19, 2005) (stating that the United States “has been consulting with the US Congress and will continue to confer with the European Communities in order to reach a mutually satisfactory resolution of this matter”). This dispute is particularly important, because it concerned two economic superpowers—the European Communities and the United States. As China’s economic power increases, it is logical to conceive that the United States’ response in *United States—Section 110(5) of the US Copyright Act* might serve as a model for China’s behavior in the WTO system.

327. See Okediji, *supra* note 177, at 822 (noting that “the choice to utilize diplomacy instead of the dispute settlement process in addressing the public health crises arguably was a superior strategic move”).

328. As one commentator noted, the United States’ approach may encourage other WTO member states “to replace effective enforcement of intellectual property rights with a cynical ‘exemptions plus compensation’ approach to TRIPS.” Richard Owens, *TRIPS and the Fairness in Music Arbitration: The Repercussions*, 25 EUR. INTEL. PROP. REV.

process is not as rule-based as its proponents have claimed, one may have to wonder what the United States can achieve through the process and, from China's perspective, what it really means when the United States files a formal WTO complaint against the country.

Moreover, China's perception of the dispute settlement process may ultimately affect developments in the international trading system.<sup>329</sup> As one commentator has noted:

the study of Chinese accession has rendered problematic many of the assumptions that have traditionally governed our (Western) understanding of the WTO and has therefore entailed the need for more appropriate alternative perspectives and scenarios of what may occur once China accedes (given its size and distinct legal and cultural traditions).<sup>330</sup>

Although commentators have feared that China's accession would lead to an "litigation explosion" and the "increasing litigiousness of the WTO dispute mechanism,"<sup>331</sup> China's behavior in the WTO in the past few years seem to have suggested otherwise. From the standpoint of dispute settlement approaches, China was closer to Japan than to the United States; "[h]istorically, [it] has never been shy to express its preference for amicable means of dispute settlement in diplomacy."<sup>332</sup> Thus, China might be skeptical of the WTO dispute settlement process, or even reluctant to use it.

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49, 53 (2003). Such an approach, according to the commentator, might undercut the minimum standards for intellectual property protection under the TRIPs Agreement while creating instability in the international trading system. *Id.*

329. See Cass et al., *supra* note 217, at 5 (observing that "China's entry to the WTO has the potential to have a significant impact upon the world trading system precisely because it occurs at a time when many of the old verities of geo-politics and law, and law and diplomacy, are being questioned"). For discussions of China's participation in the WTO dispute settlement process, see generally Henry S. Gao, *Aggressive Legalism: The East Asian Experience and Lessons for China*, in CHINA'S PARTICIPATION IN THE WTO, *supra* note 68, at 315; Liyong Jiang, *The WTO Dispute Settlement Mechanism and China's Participation*, in CHINA'S PARTICIPATION IN THE WTO, *supra* note 68, at 303.

330. Alan S. Alexandroff & Rafael Gomez, *General Introduction to CHINA AND THE LONG MARCH* *supra*, note 208, at 1, 2.

331. See Deborah Z. Cass, *China and the 'Constitutionalization' of International Trade Law*, in CHINA AND THE WORLD TRADING SYSTEM, *supra* note 27, at 40, 45 (noting the concern that "China's entry might weaken the dispute settlement system" by creating "non-compliance with Appellate Body rulings . . . [and an] overload of the dispute settlement system"). But see Sylvia Ostry, *WTO Membership for China: To Be and Not to Be—Is That the Answer?*, in CHINA AND THE WORLD TRADING SYSTEM, *supra* note 27, at 31, 38 (contending that "the issue of the increasing litigiousness of the WTO dispute settlement mechanism is a broader issue that the Chinese accession will amplify but does not create").

332. Kong, *supra* note 27, at 151; see also Pitman B. Potter, *The Evolution of Law in Contemporary China: Challenges for WTO Implementation*, in CHINA AND THE LONG MARCH, *supra* note 208, at 136, 140 (noting that "[a] comparison of WTO norms on dispute resolution with Chinese norms reveals apparent convergence in form but significant divergence in substantive performance").

## IV. PROSPECTS OF CHINA'S IMPROVEMENTS

Since the mid-1990s, China has introduced many intellectual property laws and regulations. The country now has so many laws that it is very hard for the authorities to properly enforce all of them even if they have the political will to do so. As William Alford noted insightfully, the problem with China is not a lack of laws, but the existence of too many.<sup>333</sup> Laws, nevertheless, are important, because intellectual property laws will only be as effective as they are enforced. Thus far, enforcement, has been a major stumbling block to effective protection of intellectual property rights in China.

This Part undertakes the difficult task of examining the progress China has made in the intellectual property arena. Although researchers and trade groups have provided empirical evidence of the extent of piracy and counterfeiting in China, such evidence does not track the progress China has made in the intellectual property arena. To measure progress, one has to examine not just the extent of the Chinese piracy and counterfeiting problems, but the extent of those problems when all the political, social, economic, cultural, and technological conditions are kept constant. Because China is changing very rapidly and there is no easy way to account for all the different variables, it is virtually impossible to measure the progress China has made in the intellectual property arena.

Thus, instead of attempting the futile task of developing a metric to measure China's progress, this Part explores three widely-reported legal disputes that provide insight into recent developments in Chinese copyright, patent, and trademark laws. In particular, it focuses on the unauthorized reproduction, adaptation, and distribution of "Harry Potter" novels, the State Intellectual Property Office's decision to invalidate Pfizer's patent in Viagra, and the Chinese government's heightened efforts to protect trademarks used in relation to the 2008 Beijing Olympics. Based on the belief that the protection of intellectual assets is as much a business strategy as a legal issue, this Part examines both the legal and non-legal aspects of the three disputes. While there are still many existing problems for intellectual property rights holders in China, this Part contends that many of these problems are quite different from what they were a decade ago and, therefore, warrant a new analytical perspective.

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333. See William P. Alford, *How Theory Does—and Does Not—Matter: American Approaches to Intellectual Property Law in East Asia*, 13 UCLA PAC. BASIN L.J. 8, 21 (1994) (noting that he was "tempted to write an article entitled 'Why China Has Too Much Law—And Too Little Legality'").

A. *Harry Potter*

Harry Potter is one of the most popular fictional figures of all time. Since its debut, the “Harry Potter” series has sold more than 270 million copies in sixty-two languages,<sup>334</sup> and all of the four “Harry Potter” films have swept box offices throughout the world. When Scholastic, Inc. released *Harry Potter and the Half-blood Prince*—the latest installment of the “Harry Potter” series—in July 2005, it ordered an initial print run of 10.8 million copies, followed by a second print run that brought the book’s total production to 13.5 million.<sup>335</sup> On the first day alone, the book sold an estimated 6.9 million copies in the United States, dwarfing the one-day sales record of five million set two years ago by the previous installment, *Harry Potter and the Order of the Phoenix*.<sup>336</sup>

Although the publisher had been very careful in protecting the book, going so far as to take legal action to enjoin a Canadian grocery store that had inadvertently sold the book before its scheduled release,<sup>337</sup> pirated copies became widely available on the Internet in less than twelve hours after the book hit stores.<sup>338</sup> Within two days, early chapters of the book had been translated into French, Spanish, German, and Russian without author J.K. Rowling’s authorization.<sup>339</sup> By the end of the month, an unauthorized Chinese translated version of the book—with typos and omissions—went on sale in Beijing.<sup>340</sup> According to Rowling’s attorney, more than a hundred cease-and-desist letters and take-down notices had been sent to Web sites in Brazil, Canada, China, Poland, Russia, Spain, the United Kingdom, and the United States, as well as to eBay on which pirated copies of the book were auctioned.<sup>341</sup>

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334. See Martin Hickman, *Price War Declared Over Harry Potter*, INDEP. (London), July 16, 2005, at 10 (reporting that “[t]he first five Harry Potter books have sold more than 265 million copies in 200 countries and have been translated into 62 languages”); Edward Wyatt, *Potter Book Sets Record in First Day*, N.Y. TIMES, July 18, 2005, at B3 (reporting that the latest installment of the “Harry Potter” series had sold an estimated 6.9 million copies in the United States on the first day).

335. See Wyatt, *supra* note 334.

336. *Id.*

337. See Michael Geist, *Harry Potter and the Amazing Injunction*, TORONTO STAR, July 18, 2005, at C3 (reporting that the author and publisher not only sought to enjoin the grocery store from selling the books and the book purchasers from disclosing information about the copyrighted story).

338. Jerome Weeks, *Piracy Perused*, DALLAS MORNING NEWS, July 29, 2005, at 25A.

339. Murdo Macleod, *Rowling’s Millions Get Lost in Translation*, SCOTLAND ON SUNDAY, July 31, 2005, at 11.

340. Alexa Oleson, *Presto! Potter Book Pirated in China*, CHI. TRIB., Aug. 1, 2005, at 4.

341. Richard J. Dalton Jr., *Publishers: It’s Not Nice to Share*, NEWSDAY (N.Y.), Aug. 9, 2005, at A2.

Unauthorized copying of “Harry Potter” novels was not new. In fact, there are many interesting developments concerning the previous installment.<sup>342</sup> Like *Harry Potter and the Halfblood Prince*, unauthorized translations of *Harry Potter and the Order of the Phoenix* had appeared on the Internet before the authorized version was available.<sup>343</sup> As a Chinese fan involved in the translation maintained, “[w]e wanted to create this ourselves. We wanted to encourage an exchange of views between fans. This is not a money-making operation. If anyone feels their rights are being infringed all they have to do is tell us and we will remove it.”<sup>344</sup>

In fall 2000, a raid by the Chinese authorities discovered fake *Harry Potter* books being produced by a publisher in the southwestern Chinese city of Chengdu.<sup>345</sup> Interestingly, the pirate was tracked down when Chinese private investigators found an unauthorized copy of the pirated book published with the publisher’s name. As an attorney involved in the case noted, “[t]he funny thing was, the book we bought in Guangzhou turned out to have been a fake of a fake. It had been printed by another printing house that used [the publisher’s] name.”<sup>346</sup> Once the pirated books were discovered, the publisher quickly settled the dispute, agreeing to pay a \$2,500 fine within six months and to publish an apology in China’s *Legal Times*.<sup>347</sup>

While the “Harry Potter” stories illustrated the extent of copyright piracy in China, they provide important insights into recent copyright developments in the country. First, as the Chengdu story has shown, copyright problems in China have become more complicated than they were a decade ago. Unlike the past, when the infringing products are often verbatim copies of the originals, the parties involved in the dispute these days include legitimate companies, as well as underground operations and mom-and-pop pirates. For

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342. For example, before the newest installment was even released, books purporting to be the fifth, sixth, and even the finale of the *Harry Potter* series appeared in China. Among the many “imaginary” titles were *Harry Potter and the Leopard-Walk-Up-to-Dragon*, *Harry Potter and the Golden Turtle*, and *Poor Dad, Rich Dad and Harry Potter*. Aileen Jacobson, *Harry Potter and the Wizards of Ersatz*, *NEWSDAY* (N.Y.), Nov. 14, 2002, at B2; see John Pomfret, *Chinese Pirates Rob ‘Harry’ of Magic, and Fees*, *WASH. POST*, Nov. 1, 2002, at A1.

343. See Alice Yan, *Harry Potter and the Case of Copyright Infringement*, *S. CHINA MORNING POST*, July 14, 2003, at 4 (reporting that “[a] Chinese-language version of the first 10 chapters of *Harry Potter and the Order of the Phoenix* has appeared on domestic websites three months before the book’s official release on the mainland”).

344. *Id.*

345. Jacobson, *supra* note 342; Pomfret, *supra* note 342.

346. Pomfret, *supra* note 342 (quoting Joseph Simone, attorney with the Hong Kong office of the law firm Baker & McKenzie).

347. Jacobson, *supra* note 342; Pomfret, *supra* note 342.

example, the infringing publisher in Chengdu, Bashu Publishing House, was a legitimate enterprise.<sup>348</sup> There is no doubt that their books had violated both copyright and trademark laws. However, their unauthorized products were not typical rip-offs, but rather unauthorized sequels. While the overall quality of these products may not be comparable to that of Rowling's originals, it is undeniable that the publisher and its editors had expended a substantial amount of time, skill, and effort to prepare the unauthorized products.

As the Chinese continue to learn about the law and test the limits of copyright protection, this type of infringement will increase—to the point that the infringement eventually will raise difficult questions concerning the level of substantial similarity between the originals and the allegedly-infringing products and the limits of fair use. Because courts will be in a better position to adjudicate these complex copyright questions, litigation, in the near future, is likely to become a more important protective tool than administrative enforcement.<sup>349</sup>

Unauthorized sequels like those in the Chengdu story are not limited to China; they are found in other countries. A recent example concerns the allegedly-infringing “Tanya Grotter” book series.<sup>350</sup> The protagonist of that series is a young orphan living in a magical world named Tanya Grotter.<sup>351</sup> In November 2002, Rowling's publisher sent a cease-and-desist letter to the Russian publisher, alleging copyright infringement.<sup>352</sup> The defendant claimed that the books, which were inspired by the Potter books, were rooted in Russian culture and

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348. See Jacobson, *supra* note 342 (reporting the view of the attorney involved in the case that it was easier to track down the Chengdu publisher because it was “a legitimate organization”); see also David R. Baker, *Cisco Suit Could Test Chinese Intentions*, S.F. CHRON., Jan. 28, 2003, at B1 (reporting about the intellectual property dispute between Cisco Systems and the Shenzhen-based Huawei Technologies, a legitimate telecommunications equipment manufacturer); Peter S. Goodman, *Pirated Goods Swamp China*, WASH. POST, Sept. 7, 2004, at E1 (reporting about the intellectual property dispute between General Motors and Shanghai-based Chery Automobile Company, a legitimate car manufacturer).

349. As one commentator noted, “administrative actions are more common in trademark cases where most cases are clear-cut and infringement is easy to prove. In more complex patent and copyright matters, it is more difficult to prove either the existence of a right (copyright) or the infringement (patent).” GANEA & PATTLOCH, *supra* note 116, at 290.

350. For discussions of potential copyright infringement involving the “Tanya Grotter” book series, see generally Alex Rodriguez, *Potter ‘Parody’ Conjures up Trouble*, CHI. TRIB., Dec. 15, 2002, at C5; Peter K. Yu, *The Downside of Being Harry*, IP L. & BUS., May 2003, at 26.

351. Louise Jury, *Russia’s Tanya Grotter Copies Potter’s Magic*, INDEP. (London), Nov. 8, 2002, at 13. Like Potter, Grotter wears glasses. Unlike Potter, however, Grotter is a girl who attends the Abracadabra School for Young Witches. Instead of a broomstick, she rides a double bass. Although she does not have a scar, she has an unusual mole on her nose.

352. Rodriguez, *supra* note 350.



folklore and should be considered parodies of the Potter books. Notwithstanding the parody defense, Rowling's publisher successfully obtained an injunction in the Netherlands blocking the Dutch translation of the allegedly-infringing books.<sup>353</sup>

Unauthorized prequels, sequels, and spin-offs also can be found in the developed world. A Google search, for example, reveals a large number of *Harry Potter* fanzines, fan fictions, and fan sites in Canada, the United States, and the United Kingdom, featuring stories that use without authorization "Harry Potter" characters and images from "Harry Potter" books and movies. These sites are particularly difficult for the rights holders to deal with,<sup>354</sup> because they usually are not created by traditional pirates who seek to free ride on the creative efforts of others, but rather by obsessive fans who are also avid promoters of the "Harry Potter" mystique. In December 2000, Warner Brothers learned this the hard way when it threatened to sue a fifteen-year-old English schoolgirl for putting up a Web site that used the domain name [www.harrypotterguide.co.uk](http://www.harrypotterguide.co.uk).<sup>355</sup> The studio eventually backed down after she and others organized a boycott of "Harry Potter" merchandise in protest through another Web site, [potterwar.org.uk](http://potterwar.org.uk).<sup>356</sup>

Second, local stakeholders are emerging in China, and, as a result, piracy affects both local and foreign rights holders alike. A case in point is the online release of the unauthorized Chinese versions of the "Harry Potter" novels. The unauthorized versions not only affected Rowling and her publisher, but also hurt Renmin Wenxue publishing company, the local state-owned publishing house that holds the rights to publish the Chinese translation of the "Harry Potter" books. Although the local publisher had planned to release its authorized translation of *Harry Potter and the Order of the Phoenix* in October 2003,

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353. Robyn Dixon, *Harry Potter Battles Attack of the Clones*, L.A. TIMES, Apr. 13, 2003, at 41; see Dan Lerner, *Rowling Blocks Book Publication*, FIN. TIMES (London), Apr. 4, 2003, at 6 (reporting that Rowling "won a court battle in an attempt to block the Dutch publication of a Russian novel about a girl wizard called 'Tanya Grotter' after arguing it copied one of her bestsellers").

354. For discussions of fan sites and fan fictions, see generally Rebecca Tushnet, *Legal Fictions: Copyright, Fan Fiction, and a New Common Law*, 17 LOY. L.A. ENT. L.J. 651, 664-83 (1997); Deborah Tussey, *From Fan Sites to Filesharing: Personal Use in Cyberspace*, 35 GA. L. REV. 1129, 1139-49, 1181-89 (2001).

355. See Kieren McCarthy, *Warner Bros Backs Down on Harry Potter Web Site*, THE REGISTER, Dec. 15, 2000, [http://www.theregister.co.uk/2000/12/15/warner\\_bros\\_ba](http://www.theregister.co.uk/2000/12/15/warner_bros_ba)cks\_down/ (discussing the "Potter War" between Warner Brothers and "Harry Potter" fans).

356. See *id.*

it eventually had to move its production schedule forward to protect itself against piracy, both online and offline.<sup>357</sup>

This local impact is often lost on foreign rights holders. While foreign movie producers are understandably frustrated when pirated copies of their movies appear shortly after the film release,<sup>358</sup> piracy has deeply affected the box-office success of many domestic Chinese movies, including those by acclaimed Chinese director Zhang Yimou and those featuring famous Hong Kong actors.<sup>359</sup> By compelling local products to compete against cheap, pirated copies of more sophisticated foreign software, piracy also has made the establishment and development of the local software industry very difficult.<sup>360</sup> Even Professor Zheng Chengsi, the leading Chinese academic on intellectual property law, suffered from piracy when unauthorized digital copies of his intellectual property law books were sold on the Internet.<sup>361</sup>

Moreover, piracy affects local consumers as much as it affects the rights holders. For example, fake books might have endings that are different from the originals, the entertainment one gets from a bootlegged DVD might be unsatisfactory,<sup>362</sup> and pirated software might come with harmful computer viruses.<sup>363</sup> Indeed, when British authors

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357. See Satoshi Saeki, *Harry Potter Latest Victim of China's Lucrative Piracy Mart*, DAILY YOMIURI (Tokyo), Aug. 9, 2003, at 18 (reporting that the local publisher had to move its production schedule forward to protect itself against piracy).

358. See *Star Wars Piracy Rife*, TORONTO SUN, May 23, 2005, at 24 (reporting that "[u]nauthorized copies of the latest *Star Wars* movie went on sale on the streets of Beijing . . . just days after the blockbuster film premiered in China").

359. See, e.g., Catherine Armitage, *Unlikely Hero*, WEEKEND AUSTRALIAN, Mar. 29, 2003, at B10 (attributing the box-office success of Zhang Yimou's *Hero* partly "to the elaborate and expensive effort that went into protecting it from being pirated before its release"); Joseph Kahn, *The Pinch of Piracy Wakes China Up on Copyright Issue*, N.Y. TIMES, Nov. 1, 2002, at C1 (discussing the impact of unauthorized DVDs on the action adventure movie *The Touch*); Mark Magnier, *A Tiger Still Crouching*, L.A. TIMES, Aug. 22, 2004, at E4 (reporting about how box office receipts of Zhang Yimou's *The House of Flying Daggers* had decreased dramatically after pirated copies appeared on the street).

360. See Li, *The Wolf Has Come*, *supra* note 28, at 92 (discussing how the piracy of foreign software harms the local software firms as much as the foreign software companies).

361. Mure Dickie, *Book About Copyright Is Pirated in China*, FIN. TIMES (London), Jan. 15-16, 2005, at 5 (recounting a case in China that found Beijing-based Scholar Digital guilty of offering bootlegged digital versions of a series of books on copyright piracy authored by Professor Zheng Chengsi).

362. See Nathan Lee, *Through a Lens, Darkly*, N.Y. TIMES, Dec. 19, 2004, § 2, at 1 (discussing the poor quality of bootlegged DVDs).

363. But see FISHMAN, *supra* note 254, at 244 (maintaining that "[o]ften the [software] packages sold in China's bootleg stalls perform *better* than legitimate versions, because the sellers have gone to the trouble of updating their wares with all the original manufacturers' updates, a somewhat tedious process that buyers who pay full price have to go through on their own").

petitioned the U.S. government in the nineteenth century to extend copyright protection to their works, they cautioned explicitly that the lack of effective protection of foreign copyrights would confuse the American public “as to whether the books presented to them as the works of British authors, [we]re the actual and complete productions of the writers whose names they b[ore].”<sup>364</sup>

Consider, for example, the Chinese bootlegged version of President Bill Clinton’s autobiography, *My Life*. This version not only reduced the book’s size by half, but also omitted key passages from the autobiography.<sup>365</sup> Even worse, it added new, nonexistent twists to the former president’s life. According to this pirated version, President Clinton said upon meeting Senator Hilary Clinton when she was a student, “She was as beautiful as a princess. I told her my name is Big Watermelon.”<sup>366</sup> In addition, he was found repeatedly quoting Chairman Mao Zedong, dropping such famous sayings as “You want to know the taste of the pear, then you have to eat it yourself.”<sup>367</sup>

Notwithstanding the rampant piracy problem in China, intellectual property protection has been improving in the country. As the Chinese economy grows and the middle class becomes larger, the Chinese will have more disposable income and purchasing power. When people are poor, they are more willing to settle for fake PRADA handbags or low-quality VCDs (video compact discs). When they become richer, however, they may start looking for higher-priced genuine products and luxury goods. Indeed, some commentators have suggested that China’s WTO accession might improve local living standards to the point that Chinese consumers will be more interested in buying genuine products.<sup>368</sup> As stated in a recent study by Ernst & Young:

The Chinese luxury market . . . is expected to grow 20%, annually until 2008 and then 10% annually until 2015, when sales are expected to exceed US\$11.5 billion. By 2010, China is expected to have a quarter-billion consumers who can afford luxury products, nearly 17 times the present number. By 2015, Chinese consumers

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364. S. REP. NO. 134, 24th Cong., 2d Sess., ¶ 9 (1837), *reprinted in* R.R. BOWKER, COPYRIGHT, ITS HISTORY AND LAW: BEING A SUMMARY OF THE PRINCIPLES AND LAW OF COPYRIGHT, WITH SPECIAL REFERENCE TO BOOKS 341, 343 (1912).

365. See Oliver August, *Clinton’s Mentor Was Mao, Chinese Readers Are Told*, TIMES (London), July 21, 2004 (reporting about how President Clinton’s autobiography has been truncated and modified).

366. *Id.*

367. *Id.*

368. See, e.g., CHOW, *supra* note 64, at 254 (suggesting that China’s WTO accession might improve living standards and encourage Chinese consumers to buy genuine and legitimate products).

could be as influential as the Japanese and account for 29% of all global luxury goods purchases.<sup>369</sup>

Third, the Chinese market is large, unique, and complex. The conventional wisdom about how one does business in a foreign country, therefore, may not be applicable to the country. Commentators have emphasized the correlation between intellectual property protection and foreign direct investment.<sup>370</sup> However, studies have shown that many companies that are doing business in China are not particularly concerned about intellectual property issues.<sup>371</sup> Rather, they are there to take advantage of the lower labor and production costs,<sup>372</sup> or to build up their market share and position before the Chinese economy takes off.

As Microsoft's founder Bill Gates famously noted on PBS in an exchange with Warren Buffett, chairman of Berkshire Hathaway Inc.:

Although about three million computers get sold every year in China, people don't pay for the software. Someday they will, though. And as long as they're going to steal it, we want them to steal ours. They'll get sort of addicted, and then we'll somehow figure out how to collect sometime in the next decade.<sup>373</sup>

To a great extent, Mr. Gates rightly sees piracy losses as promotional expenses needed to capture an emerging market. Had it not been for the widespread piracy of Microsoft's products, these products would not have become the industry standard in China.<sup>374</sup> Interestingly,

369. ERNST & YOUNG, CHINA: THE NEW LAP OF LUXURY I (2005), [http://www.ey.com/global/download.nsf/China\\_E/050914\\_Report\\_E/\\$file/China-The%20New%20Lap%20of%20Luxury\\_Eng%20\(Final\).pdf](http://www.ey.com/global/download.nsf/China_E/050914_Report_E/$file/China-The%20New%20Lap%20of%20Luxury_Eng%20(Final).pdf).

370. See Josh Martin, *Copyright Law Reforms Mean Better Business Climate*, J. COM., Mar. 7, 1996, at 2C (reporting on a World Bank survey of major U.S. companies that demonstrated the correlation between intellectual property protection and foreign investment).

371. See Paul Tackaberry, *Intellectual Property Risks in China: Their Effect on Foreign Investment and Technology Transfer*, J. ASIAN BUS., Fall 1998, at 34, 45, quoted in Li, *The Wolf Has Come*, *supra* note 28, at 79 n.9 (suggesting that the size and promise of the Chinese market provides the main attraction for foreign direct investment); see also Carlos A. Primo Braga & Carsten Fink, *The Relationship Between Intellectual Property Rights and Foreign Direct Investment*, 9 DUKE J. COMP. & INT'L L. 163, 164 (1998) (stating that "the available empirical evidence does not conclusively establish the relationship between IPRs and FDI decisions").

372. See Maskus, *supra* note 289, at 123 (identifying "market size and growth, local demand patterns, transport costs and distance from markets, low wage costs in relation to labor productivity, abundant natural resources, and trade protection that could encourage 'tariff-jumping' investments" as examples of "location advantages"); see also Heald, *Mowing the Playing Field*, *supra* note 145, at 258-60 (discussing the different concerns about intellectual property protection between the marketing division and the research and manufacturing division of a foreign company).

373. Brent Schlender et al., *The Bill & Warren Show*, FORTUNE, July 20, 1998, at 48.

374. As Lawrence Lessig has observed:

When the Chinese "steal" Windows, that makes the Chinese dependent on Microsoft. Microsoft loses the value of the software that was taken. But it

though, Chinese leaders have recently pushed for the expanded use of open source software by government agencies as a substitute to expensive Microsoft products.<sup>375</sup> To ward off competition, Microsoft had agreed, in response, to provide the Chinese authorities with access to its proprietary code while donating computers and software to state agencies and local schools.<sup>376</sup> One may wonder whether Mr. Gates overstated the appeal of his promotional strategy or whether he is still trying to “figure out how to collect sometime in the next decade.”

Fourth, for those companies that have successfully adapted to the local market environment, rampant piracy and counterfeiting problems, though annoying, did not affect their ability to make profits. For example, the Chinese licensee of the “Harry Potter” books sold more than a million copies despite the widespread piracy problem, both online and offline.<sup>377</sup> On the first day alone, the book sold more than 10,000 copies, setting a Chinese national record for daily sales.<sup>378</sup> Similarly, many major Western companies—like Coca-Cola, Kodak, Motorola, and Procter & Gamble—have been enjoying substantial profits for years even though they were confronted with serious piracy and counterfeiting problems.<sup>379</sup>

To be successful, business executives need to remember that “China is . . . not a ‘get rich quick’ market or one for the faint hearted.”<sup>380</sup> While business executives and pundits often talk about the proverbial

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gains users who are used to life in the Microsoft world. Over time, as the nation grows more wealthy, more and more people will buy software rather than steal it. And hence over time, because that buying will benefit Microsoft, Microsoft benefits from the piracy. If instead of pirating Microsoft Windows, the Chinese used the free GNU/Linux operating system, then these Chinese users would not eventually be buying Microsoft. Without piracy, then, Microsoft would lose.

LAWRENCE, LESSIG, *FREE CULTURE: HOW BIG MEDIA USES TECHNOLOGY AND THE LAW TO LOCK DOWN CULTURE AND CONTROL CREATIVITY* 65 (2004).

375. See Li, *The Wolf Has Come*, *supra* note 28, at 106 (reporting that “[i]n August 2002, the open source operating system called Yangfan (or ‘raise the sail’) Linux was released by a government-sponsored software development group in China, which is expected to replace Windows and Unix on all Chinese government PCs and servers”).

376. See FISHMAN, *supra* note 254, at 247 (noting Microsoft’s agreement to provide the Chinese authorities with access to its proprietary code and its donations of computers and software to state agencies and local schools); Henry Chu et al., *Developing Nations See Linux as a Savior from Microsoft’s Grip*, L.A. TIMES, Aug. 9, 2004, at A4 (reporting about Microsoft’s opening up of its proprietary code to governments); Steve Lohr, *Microsoft to Give Governments Access to Code*, N.Y. TIMES, Jan. 15, 2003, at C10 (same).

377. See *Harry Potter Wins Press Award in China with a Million Copies Sold Last Year*, XINHUA GEN. NEWS SERV., Sept. 2, 2004, LEXIS, News Library, ALLNWS File.

378. *Id.*

379. SUN, *supra* note 23, at 4.

380. CHEE, *supra* note 152, at 29.

market of 1.3 billion people, that market does not exist.<sup>381</sup> Indeed, most of the successful foreign companies in China understand the actual market conditions of the country and are well-prepared for the many challenges of the emerging market, including widespread piracy and counterfeiting. For these companies, an improvement in intellectual property protection merely “increas[es the] already acceptable profit ratios,” rather than being the necessary precursor to profitability in the first place.<sup>382</sup>

Finally, as the widespread online piracy of the “Harry Potter” books has illustrated, the problem that rights holders encounter on the Internet are not that different from the massive copyright piracy they face in China. To be fair, the former is different from the latter; while the former focuses on commercial copying, the latter consists of primarily private or noncommercial copying. Nevertheless, U.S. courts have not embraced this public-private, commercial-noncommercial distinction. In *A&M Records, Inc. v. Napster, Inc.*,<sup>383</sup> for example, the United States District Court for the Northern District of California stated clearly that the use of the Napster file-sharing service could not be considered private use or “personal use in the traditional sense,” partly because users reaped economic benefits by “get[ting] for free something they would ordinarily have to buy.”<sup>384</sup> Although commentators have widely criticized the court’s interpretation of the word “commercial,”<sup>385</sup> the court’s reasoning seems to suggest that there are remarkable similarities between the Chinese piracy problem and the unauthorized copying problem on the Internet.<sup>386</sup>

### B. *Viagra*

In July 2003, the State Intellectual Property Office (“SIPO”) invalidated Pfizer’s patent in sildenafil citrate, a key ingredient of Viagra.<sup>387</sup> Although SIPO’s ruling has yet to be published and it is

381. See *id.* at 3-9 (discussing the myth of a market of 1.3 billion people).

382. SUN, *supra* note 23, at 5.

383. 114 F. Supp. 2d 896 (N.D. Cal. 2000).

384. *Id.* at 912.

385. See, e.g., WILLIAM W. FISHER, III, PROMISES TO KEEP: TECHNOLOGY, LAW, AND THE FUTURE OF ENTERTAINMENT 118 (2004) (noting that the appellate court’s rejection of the characterization of sampling as “noncommercial” in nature was troublesome, because under the court’s interpretation “virtually every unauthorized use of a copyrighted work would be ‘commercial’ in character”).

386. See generally Yu, *The Copyright Divide*, *supra* note 207 (comparing the massive copyright piracy in China to that of the Internet).

387. Paul Mooney, *China Challenging Drug Patents*, SCIENTIST, Aug. 20, 2004, <http://www.the-scientist.com/news/20040820/02>; accord *Pfizer v. China*, RED HERRING, Aug. 26, 2004, <http://www.redherring.com/article.aspx?a=10812>. See generally Geoffrey K. Cooper, *Patent Invalidation in Post-WTO China: Pfizer’s Sildenafil Use*, JURISNOTES.COM,

unclear how the patent was struck down, media reports suggested that Pfizer might have failed to disclose sufficient information about the drug and how it was able to cure impotence.<sup>388</sup> As a Beijing attorney surmised, “Pfizer may have been caught in a catch-22: they may have provided just enough information to the patent office to meet local requirements, while holding back some key details to protect the process from counterfeiters in China.”<sup>389</sup>

After the decision, commentators quickly criticized China for its lack of commitment to protect intellectual property rights.<sup>390</sup> Some also suggested that SIPO’s ruling might violate China’s obligations under the TRIPs Agreement, which requires all member countries to protect patents regardless of “the place of invention, the field of technology, and whether products are imported or locally produced.”<sup>391</sup> As the former director of policy planning at the USTR noted:

Faced with rising global pressure to crack down on patent infringement, Beijing may be in the process of redefining patent criteria effectively to safeguard Chinese drug-makers from accusations of illegal infringements. The removal of patents on Viagra or Avandia would offer Chinese companies free rein to manufacture homegrown copycat drugs without fear of prosecution. If these cases continue in their current direction, China may in the process violate its obligations to the WTO.

For the global research pharmaceutical industry, the ruling carries the significant threat of a Chinese government tacitly supporting the production of counterfeit drugs by domestic Chinese companies. For China’s trading partners worldwide, the ruling demonstrates China’s somewhat cautious embrace of the WTO’s rules-based system, which it joined in 2002.<sup>392</sup>

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<http://www.jurisnotes.com/IP/articles/patentinvalidation.htm> (last visited Nov. 17, 2005) (discussing the legal issues involved in the reexamination proceeding).

388. See Andrew Yeh, *Chinese Set Date for Viagra Patent Appeal*, FIN. TIMES (Asia), Mar. 30, 2005, at 18 (reporting that “Chinese officials argued the US group did not provide sufficient description of the drug and was unable to prove Viagra was able to cure impotence”).

389. Mooney, *supra* note 387.

390. See, e.g., Dudley Schleier, *Pfizer Clarifies China’s Reversal of Viagra Patent*, STRAITS TIMES (Sing.), Aug. 6, 2004, at 24 (maintaining that “China’s decision to overturn the Viagra patent . . . does indeed break new and unsettling legal ground . . . [and] sends a very disturbing message to all who are concerned about China’s commitment to intellectual property right”).

391. TRIPs Agreement, *supra* note 17, art. 27(1).

392. Naotaka Matsukata, *China’s Counterfeit Commitment to Patents*, FIN. TIMES, Aug. 5, 2004, at 17; see also *China’s Viagra Heist*, WALL ST. J., July 12, 2004, at A16 (criticizing SIPO’s ruling for “ignor[ing] market principles, its own World Trade Organization commitments and the long-term interests of its people by overturning the drug’s patent”).

What these critics failed to realize, or at least acknowledge, was that SIPO's decision was exactly what intellectual property rights holders *should* expect in a country making transition to full compliance with the WTO agreements. Indeed, it was the first time Chinese companies took the legal route to challenge a patent owned by a major foreign company. A decade ago, local companies simply ignored the law and manufactured counterfeit products; many still do today. This time, however, local companies went to the patent office first, asking for the cancellation of Pfizer's patent for its failure to satisfy the novelty requirement.<sup>393</sup> That is a great improvement and is largely due to the legal reforms introduced in the wake of the WTO accession.<sup>394</sup>

Five weeks after SIPO's ruling, seventeen Chinese pharmaceutical companies joined together to explore how they could use their combined manufacturing and marketing capabilities to domestically produce a version of Viagra.<sup>395</sup> While Pfizer was certainly unhappy with this alliance, it was not particularly worried about the Chinese market. Although the market has grown quickly and is forecasted to be the world's fifth largest pharmaceutical market by 2010,<sup>396</sup> China provides only a small market for Viagra, because the drug is deemed a controlled substance and can only be legally sold in a few hospitals.<sup>397</sup> Moreover, widespread counterfeiting had significantly damaged the market; Pfizer estimated that ninety percent of the drug sold in China was fake.<sup>398</sup>

Unlike the Chinese market, the international market is very important to Pfizer. In 2003 alone, the company earned \$1.88 billion from the international market.<sup>399</sup> Because SIPO's ruling has the potential to encourage Chinese pharmaceutical companies to produce

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393. Although SIPO has not released its decision, an official indicated that the patent had been revoked—not because of the novelty requirement—but because of Pfizer's failure to adequately describe the "technological" uses of sildenafil citrate.

394. As one attorney noted, "[a]s long as people are interested in dealing with commercial disputes through court, it is a sign that a country is developing a proper legal system rather than ignoring it." *Pfizer v. China*, *supra* note 387 (quoting Doug Clark, an intellectual property rights attorney at Lovells who has practiced law in China for about a decade).

395. *Id.*

396. See SUN, *supra* note 23, at 143 (citing the July 2002 report from the Boston Consulting Group reporting that "China's pharmaceutical market has grown at an average annual rate of 14% for the past decades").

397. See Phelim Kyne et al., *China Voids Pfizer's Viagra Patent*, WALL ST. J., July 8, 2004, at A3 ("Viagra sales in China remain small, hampered by the Ministry of Health's classification of the drug as a controlled substance. That classification bans advertising and limits the drug's distribution by prescription to only a small number of hospitals.").

398. See Mooney, *supra* note 387.

399. See Kyne et al., *supra* note 397 (reporting that Viagra's worldwide sales "last year rose 8% to \$1.88 billion").



generic versions of the drug that can be exported to foreign markets, Pfizer was understandably concerned about the decision. Indeed, if these Chinese generics are exported to other markets, like those in the United States and other developed countries, they will compete directly against Pfizer's pills, driving down prices and cutting into the company's profits.

At the industry level, SIPO's ruling presented a different problem. To the concern of the foreign pharmaceutical industry, the Viagra ruling had the potential of setting a precedent that could spark a new trend of systematic revocation of foreign pharmaceutical patents by Chinese stakeholders. Indeed, because of the Viagra decision, GlaxoSmithKline PLC decided to abandon its patent for rosiglitazone, a major ingredient of its popular diabetes drug Avandia; the Avandia patent had been similarly challenged by local pharmaceutical manufacturers.<sup>400</sup>

Nevertheless, it remains unclear whether the Viagra decision was an isolated incident. After all, inventors challenge patents all the time and all over the world, and most countries accommodate these challenges by providing a reexamination or opposition procedure in their patent law. For example, U.S. patent law provides for a comprehensive reexamination procedure,<sup>401</sup> which states that "[a]ny person at any time may file a request for reexamination by the [U.S. Patent and Trademark] Office of any claim of a patent on the basis of any prior art cited under the provisions of [the patent statute]."<sup>402</sup> The statute also invites third parties to "cite to the Office in writing prior art consisting of patents or printed publications which that person believes to have a bearing on the patentability of any claim of a particular patent."<sup>403</sup>

The Chinese patent statute is not that different from the U.S. patent statute. Article 45 of the Chinese Patent Law, which was used by the local pharmaceutical companies in their challenge of Pfizer's patent, provides: "[w]here . . . any entity or individual considers that the grant of the . . . patent right is not in conformity with the relevant provisions of this Law, it or he [or she] may request the Patent

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400. Richard McGregor, *Glaxo Fight to Defend Diabetes Patent in China Is Abandoned*, FIN. TIMES, Aug. 19, 2004, at 21. As reported in that case, the local companies argued that GSK's patent, which was registered before 1993, "was only granted for the compound in one particular formulation." Because the Chinese patent law did not permit basic compound patents until 1993, they were entitled to make the same compound using other formulations. *Id.*

401. See 35 U.S.C. §§ 301-307 (2000) (laying out the law for prior art citations and the procedure for ex parte reexamination of patents).

402. *Id.* § 302.

403. *Id.* § 301.

Reexamination Board to declare the patent right invalid.”<sup>404</sup> The Implementing Regulations of the Patent Law also offer detailed information about the procedure to be used by the Patent Reexamination Board.<sup>405</sup>

Shortly after SIPO’s ruling, some Pfizer executives and commentators accused SIPO of giving preferential treatment to local companies,<sup>406</sup> citing the fact that the patent challenge was brought by leading local pharmaceutical manufacturers, such as Tonghua Hongtaomao Pharmaceutical and Lianxiang Pharmaceutical.<sup>407</sup> While the decision no doubt benefits local companies, it also benefits other foreign pharmaceutical companies—in particular generic drug companies—which, until now, have been unable to manufacture their versions of Viagra in China. If they decide to compete directly with the Chinese companies, there is no guarantee that local companies will prevail. For example, generic drug companies in India have very advanced technological capabilities and are increasingly challenging patents in developed country markets.<sup>408</sup>

Nevertheless, the position taken by those mounting the accusation is understandable, when one considers the lack of transparency in SIPO’s ruling and the fact that the reversed decision was made two years after a seven-year review of the patent application.<sup>409</sup> The

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404. Chinese Patent Law, *supra* note 20, art. 45. For a detailed description of the patent invalidation process under the Chinese patent law, see generally SUN, *supra* note 23, at 27-28; Sun, *supra* note 35, at 285-96.

405. See Implementing Regulations of the Patent Law of the People’s Republic of China (promulgated by the State Council, June 15, 2001) (P.R.C.), [http://www.sipo.gov.cn/sipo\\_English/flfg/zlflfg/t20020327\\_33871.htm](http://www.sipo.gov.cn/sipo_English/flfg/zlflfg/t20020327_33871.htm) (laying out the procedure to be used by the Patent Reexamination Board).

406. See *China’s Viagra Heist*, *supra* note 392 (“[T]he decision in favor of a group of Chinese pharmaceutical companies who had petitioned the SIPO demonstrates a troubling pattern. Although it is under international pressure to respect intellectual property rights, China is acceding to the demands of its own companies for patent-nullification.”); see also Matsukata, *supra* note 392 (noting that “[t]he removal of patents on Viagra or Avandia would offer Chinese companies free rein to manufacture homegrown copycat drugs without fear of prosecution”).

407. See, e.g., Kyne et al., *supra* note 397 (reporting that the challenge on the Viagra patent was brought by leading local pharmaceutical manufacturers).

408. See Sue Reisinger, *A Generic Takes on a Drug Giant*, NAT. L.J., Jan. 10, 2005, at 8 (discussing the aggressive effort by the New Delhi-based generic drug manufacturer Ranbaxy Laboratories Limited to challenge Pfizer’s patent in its cholesterol drug Lipitor); Meir Perez Pugatch, *Intellectual Property, Data Exclusivity, Innovation and Market Access*, in NEGOTIATING HEALTH, *supra* note 108, at 97, 117 (“Two notable examples of the shift in the strategy of generic companies reported in the press are the cases of . . . Ranbaxy challenging the patent of Lipitor—Pfizer’s best selling cholesterol drug—and Dr. Reddy’s Laboratories . . . challenging the basic patent of Zyprexa—Eli Lilly’s best-selling schizophrenia drug.”).

409. See Connie Carnabuci & Peter Yuen, *Improve Your Chances of Success*, MANAGING INTELL. PROP., June 2005, at 35 (maintaining that the Patent Re-examination Board’s “revers[al of] the decision made by the SIPO in 2001 after a seven-year review of the

situation was worsened by the perplexing rationale given by SIPO for the invalidation. While the Viagra patent was struck down on novelty grounds in the United Kingdom and before the European Patent Office, SIPO faulted Pfizer for its failure to disclose sufficient information in its patent description.<sup>410</sup> As a Pfizer executive said in his company's defense, "[testing] data was neither required nor even requested at the time the Viagra patent was granted in 2001 but it was retroactively used as a basis for overturning the government's initial approval."<sup>411</sup>

Fortunately for Pfizer (and other foreign pharmaceutical companies), SIPO does not have the final say over the validity of the Viagra patent, thanks to the many intellectual property law reforms introduced since the early 1990s. Article 46 of the Chinese Patent Law provides the holders of invention patents, design patents, and utility models with the right to seek judicial review of administrative proceedings.<sup>412</sup> In March 2005, Pfizer's appeal was heard in the First Intermediate People's Court in Beijing. Although it is hard to predict whether the court will uphold SIPO's ruling on stated or other grounds, the case is likely to receive very careful treatment now that the ruling has received considerable international attention. Hopefully, the court will decide the case with solid evidence and sound legal reasoning, rather than through an accommodation of either domestic or foreign interests.<sup>413</sup>

Regardless of the outcome, any evaluation of the Viagra decision needs to take into account the peculiar characteristics of Viagra's discovery and the many legal troubles confronting the drug. After all, Viagra may be a special case, and what SIPO did in the present ruling may not reflect how it will handle the patents in other drugs. When

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patent application made the decision seem irrational," particularly because during the seven-year period there was no indication that Pfizer was not in compliance with Chinese regulations regarding patent descriptions).

410. See Chinese Patent Law, *supra* note 20, art. 26(3) (stipulating that "[t]he description shall set forth the invention or utility model in a manner sufficiently clear and complete so as to enable a person skilled in the relevant field of technology to carry it out; where necessary, drawings are required").

411. Schleier, *supra* note 390.

412. See Chinese Patent Law, *supra* note 20, art. 46 (stipulating that "[w]here the patentee or the person who made the request for invalidation is not satisfied with the decision of the Patent Reexamination Board declaring the patent right invalid or upholding the patent right, such party may, within three months from receipt of the notification of the decision, institute legal proceedings in the people's court").

413. Cf. Cooper, *supra* note 387 (arguing that "[i]t is important to China's international legal reputation for the invalidation of the sildenafil use patent to be supported by solid evidence and sound legal reasoning, and not to appear to be a cynical accommodation by China's government of the interests of domestic manufacturers").

Pfizer applied for the patent in the early 1990s, Viagra was conceived as a potential drug for heart problems.<sup>414</sup> Pfizer soon discovered that the drug had a better use for treating male erectile dysfunction and filed a second patent. Although the United States and many countries allowed Pfizer to patent this new and unintended use, some countries did not. In addition to the United Kingdom and the European Patent Office, the patent was also invalidated in countries in South America.<sup>415</sup>

The invalidations are understandable, as it is unrealistic to assume that patent offices and courts in other countries will uphold a patent merely because it is valid in the United States. Due to philosophical differences and diverging local conditions, decision-makers sometimes come to different conclusions even when they apply identical laws to identical facts. Moreover, there has been a growing debate about the low quality of patents granted in the United States.<sup>416</sup> The fact that Pfizer has a valid patent in the United States now does not mean that the patent will not be invalidated in the future. Indeed, following Pfizer's lawsuit against its competitors over erectile dysfunction drugs, the U.S. Patent and Trademark Office is currently reviewing the patent for Viagra.<sup>417</sup>

In the years to come, the Chinese pharmaceutical industry will grow rapidly. Coupled with the increasing respect for the rule of law, this growth will lead to an explosion of patent challenges and litigations.<sup>418</sup>

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414. See *id.* (providing the scientific background of sildenafil citrate and revealing the molecular class's original claimed medicinal uses).

415. See, e.g., Tony Chen, *Western Ways, Good and Bad*, FIN. TIMES (Asia), July 21, 2004, at 10 (providing a brief history of the development of Viagra and discussing the revocation of the Viagra patent by a U.K. court and the European Patent Office); Andy Ho, *The Hoopla over Viagra Patenting in China*, STRAITS TIMES (Sing.), July 14, 2004, at 16 (reporting about the invalidation of the Viagra patent in the United Kingdom, Colombia, and Venezuela as well as by the European Patent Office); Kyne et al., *supra* note 397 (reporting that "in 2001, the patent was disallowed in Bolivia, Colombia, Ecuador, Peru and Venezuela over a different issue").

416. For discussions of problems within the patent system, see generally FED. TRADE COMM'N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (2003), <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>; ADAM B. JAFFE & JOSH LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT (2004); STEPHEN A. MERRILL ET AL., A PATENT SYSTEM FOR THE 21ST CENTURY (2004). As John Thomas explained, "[b]udgetary limitations, an exploding filing rate, and the increasing range of patentable subject matter are among the reasons that U.S. patent quality appears to be on the decline." John R. Thomas, *The Responsibility of the Rulemaker: Comparative Approaches to Patent Administration Reform*, 17 BERKELEY TECH. L.J. 727, 728 (2002).

417. See *Pfizer v. China*, *supra* note 387; see also Kyne et al., *supra* note 397 (discussing Pfizer's disputes with Eli Lilly/ICOS and Bayer over their erectile dysfunction drugs Cialis and Levitra).

418. See Chen, *Western Ways, Good and Bad*, *supra* note 415 ("Intellectual property disputes have also mushroomed. Chinese companies are incorporating litigation into

This explosion would be worsened by the fact that “[t]he increased numbers of commercial disputes brought on by the market reforms have created a certain degree of institutional competition for a share of the dispute resolution ‘market.’”<sup>419</sup>

Although commentators and foreign business executives have expressed concern that excessive litigation will raise drug prices and, therefore, will hurt both foreign rights holders and local consumers, there is no easy alternative. It is unrealistic to expect local companies to abide by the laws solely for the benefit of their foreign competitors. As the Chinese learn to respect the rule of law, they might have to test the system to learn its boundaries and how it operates. This increased litigation will no doubt leave commentators wondering whether the number of lawsuits is increasing rapidly because “China is becoming a place where business disputes are resolved by rule of law or [rather because] it is simply adopting a ‘bad’ habit of the west.”<sup>420</sup>

### C. Olympics

In July 2001, Beijing won the bid to host the Olympic Games in 2008.<sup>421</sup> Like the successful bids by Tokyo in 1964 and Seoul in 1988, this bid strongly suggests China’s emerging world power status and may help position the country in the global economy.<sup>422</sup> Because the Games will generate significant international attention, Chinese leaders are likely to use this widely-anticipated event to transform the country’s world image. Some commentators, therefore, have suggested that the Beijing Olympics will provide a perfect opportunity for China to strengthen intellectual property rights.<sup>423</sup> As one

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their business strategy. Over 9,000 lawsuits were filed in China in 2003.”).

419. Potter, *supra* note 332, at 142.

420. Chen, *Western Ways, Good and Bad*, *supra* note 415.

421. Jere Longman, *Beijing Wins Bid for 2008 Olympic Games*, N.Y. TIMES, July 14, 2001, at A1.

422. As one commentator noted:

Olympic Games in East Asia—Tokyo in 1964, Seoul in 1988—are not just about throwing a few javelins around, but are primarily about positioning the nation in the global community. For Japan, 1964 represented its “return” as an upstanding member of the world community after its defeat and humiliation in the Second World War—the following year it joined the OECD. As for South Korea, the 1988 Olympics (also followed by the country joining the OECD) provided a strong boost to political reform, among other things allowing the country to enter the international arena as a constructive and credible player, turning its back on the “hermit kingdom” it had been for most of its history.

Jean-Pierre Lehmann, *China and the East Asian Political-economic Model*, in DOES CHINA MATTER? A REASSESSMENT: ESSAYS IN MEMORY OF GERALD SEGAL 87, 104 (Barry Buzan & Rosemary Foot eds., 2004).

423. See, e.g., Stacey H. Wang, Note, *Great Olympics, New China: Intellectual Property Enforcement Steps Up to the Mark*, 27 LOY. L.A. INT’L & COMP. L. REV. 291, 293 (2005)

commentator noted, “[w]inning the 2008 Olympics bid has not only given China a chance to demonstrate its cultural prowess, but it has also made intellectual property enforcement relevant to the Party agenda.”<sup>424</sup>

Since the successful bid, the Chinese government has introduced various measures to protect the Olympic-related marks, which include “the Olympic symbol, motto, flag, emblems, anthem, flame, and torch.”<sup>425</sup> In November 2001, the Beijing municipal government issued a decree on the Protection of Olympic Intellectual Property Provisions by the Beijing Municipality, which protects the intellectual property rights associated with the Olympics.<sup>426</sup> A month later, the Beijing 2008 Olympic Games Organizing Committee set up a legal affairs department to protect all of those rights.<sup>427</sup> As a senior department official explained, “[t]he establishment of the legal department is the first ever in the history of Chinese sports. . . . During the bidding stage we have committed ourselves to the protection of the Olympic intellectual property rights. It is our indispensable responsibility.”<sup>428</sup> In addition, China also enacted the Regulations on the Protection of Olympic Insignia and the Measures for the Recordal and Administration of Olympic Insignia,<sup>429</sup> while the authorities have been actively cracking down on infringements and the sale of fake Olympic merchandises.<sup>430</sup>

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[hereinafter Wang, *Great Olympics, New China*] (contending that “the 2008 Olympics is in a unique position to set the framework for legal adherence to the rights of foreign intellectual property owners”); Steve Friess, *The Trouble with Olympic Trinkets*, USA TODAY, Dec. 12, 2001, at 6B (quoting Michael Payne, marketing director of the International Olympic Committee, in his assertion that “[t]here are high expectations and hopes that the Olympics will be an important catalyst for China’s trademark protection, just as it was in Korea”). But see Rosie DiManno, *Games Won’t Change Way Chinese Do Business*, TORONTO STAR, July 16, 2001, at C9 (suggesting that “letting the Chinese in the front door . . . would predictably result in knock-offs going out the back door” and that this was “simply a characteristic of Chinese business, with its clever distribution fraud and its grey market, its corruption and espionage”).

424. Wang, *Great Olympics, New China*, *supra* note 423, at 310.

425. *Id.* at 300.

426. *Beijing Sets up Department to Protect Olympics Logo*, XINHUA NEWS AGENCY, Dec. 27, 2001, LEXIS, News Library, ALLNWS File (reporting on the establishment of the first local law on Olympics intellectual property rights and the first legal department in the history of Chinese sports).

427. *Id.*

428. *Id.*

429. Wang, *Great Olympics, New China*, *supra* note 423, at 302.

430. See Catherine Armitage, Editorial, *Run Rings Around Thieves*, WEEKEND AUSTRALIAN, Aug. 16, 2003, at T6 (reporting that “60,000 bureaus and 440,000 personnel across China would be working round the clock between now and 2008 to protect the Olympic trademarks”); Nailene Chou Wiest, *Beijing Cracks Down on Fakes*, S. CHINA MORNING POST, Apr. 16, 2005, at A7 (reporting that “[a]s it prepares to host the 2008 Olympics, Beijing is trying to burnish its image as an international city by cracking down on counterfeit brand-name goods and the ubiquitous hawkers of

While the International Olympic Committee might have included stipulations in the Host City Contract that called for these heightened efforts of protection, the growing awareness and understanding of trademark law among the Chinese leaders and local businesses is not to be overlooked. When Legend, China's leading manufacturer of personal computers, expanded overseas a few years ago, it learned painfully that its name had already been registered and used in many other countries.<sup>431</sup> As a result, the company had to change its name to LENOVO.<sup>432</sup> Such a name has since become famous around the world following the extensive Western media coverage of Lenovo's purchase of IBM's personal computers division.

Today, a number of local companies have already achieved prominence in the international market, with their trademarks being recognized as well-known outside of China.<sup>433</sup> Examples of these famous local brands include GALANZ (for microwave ovens), HAIER (for household appliances), HUAWEI TECHNOLOGIES (for telecommunications equipment), KONKA (for televisions), LENOVO (for personal computers), and TCL (for televisions). Even the monks of the Shaolin Temple reportedly have sought to register the name of their temple as a trademark.<sup>434</sup>

From the standpoint of China's internal development, strengthening the country's trademark protection makes a lot of sense. As commentators have noted, there are two primary reasons why countries were reluctant to offer stronger trademark protection. First, the country wants to encourage its export businesses to free ride on the investment of foreign trademark holders by earning profits as if they were selling genuine goods that bear the infringing trademarks. This competitive strategy is misguided, because it "will result in a parasitical business that will always be dependent on the willingness of

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pirated CDs"). But see Irene Wang, *Fake Olympic Shirts Make Quick Debut*, S. CHINA MORNING POST, Aug. 13, 2003, at A4 (reporting that "[a] week after the logo for the 2008 Beijing Olympics was unveiled, pirated T-shirts and other souvenirs bearing the emblem have appeared on sale at several markets in the capital").

431. See Mark Hall, *Welcome, China*, COMPUTERWORLD, Dec. 13, 2004, at 18.

432. See *id.*; Bruce Einhorn & Dexter Roberts, *A New Twist in Legend's Tale*, BUS. WK., June 23, 2003, at 50.

433. See generally DONALD N. SULL WITH YONG WANG, *MADE IN CHINA: WHAT WESTERN MANAGERS CAN LEARN FROM TRAILBLAZING CHINESE ENTREPRENEURS* 8-13 (2005) (providing interesting profiles of successful Chinese local brands in the areas of information technology, telecommunications equipment and services, food and beverage, and electronic appliances).

434. See *Call My Lawyer, Grasshopper*, TORONTO SUN, Sept. 26, 2002, at 88 (reporting that the Shaolin Temple "has been trying to register 'Shaolin' and 'Shaolin Temple' as trademarks with Chinese authorities . . . [and has] . . . set up a firm, Henan Shaolin Temple Industrial Development Ltd., to safeguard the temple's name").

the targeted countries to tolerate the infringing imports . . . [and that] will never have an established market position that can lay a foundation for the development of an internationally competitive business.”<sup>435</sup> In fact, it does not require much investment to create a famous trademark, and even less developed countries have succeeded in doing so; CORONA (for Mexican beer) and TSINGTAO (for Chinese beer) are good examples.<sup>436</sup>

Second, the country does not want its consumers to pay a higher premium just because a foreign trademark has established a reputation with consumers in the country. From the perspective of economic development, this argument makes a lot of sense. By not protecting famous trademarks, it will save foreign exchange and makes consumer products more affordable for its people. Unfortunately, the strategy will ultimately backfire on local consumers, who will be unable to use trademarks to identify the source of origin of goods and services due to widespread counterfeiting. As a result, local consumers not only will have to spend more time searching for the products, but will have no guarantee that they will get the products they want.<sup>437</sup> Consumer confidence, therefore, will suffer. In fact, with no or only limited trademark protection, producers will have little incentive to control the quality of their products.<sup>438</sup> Thus, consumers often will get at inflated prices poor-quality goods, some of which may expose them to health and safety risks.<sup>439</sup>

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435. Kitch, *supra* note 207, at 168.

436. See Janet H. MacLaughlin et al., *The Economic Significance of Piracy, in* INTELLECTUAL PROPERTY RIGHTS: GLOBAL CONSENSUS, GLOBAL CONFLICT?, *supra* note 275, at 89, 104 (discussing the Corona example as a success story for the creation of trademarks in a less developed country to drive innovation and economic development).

437. See, e.g., *Ty Inc. v. Perryman*, 306 F.3d 509, 510 (7th Cir. 2002) (stating that “[t]he fundamental purpose of a trademark is to reduce consumer search costs by providing a concise and unequivocal identifier of the particular source of particular goods”); Stacey L. Dogan & Mark A. Lemley, *Trademarks and Consumer Search Costs on the Internet*, 41 HOUS. L. REV. 777, 778 (2004) (stating that “[b]y protecting against deceptive uses of trade symbols in commerce, the law enables sellers to create their own reliable shorthand to identify their goods and reduces search costs for consumers”); William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 270 (1987) (stating that “the benefits of trademarks in lowering consumer search costs presuppose legal protection of trademarks”).

438. See Kitch, *supra* note 207, at 168 (maintaining that “the mark the firms desire to copy will inevitably lose its reputation in the less developed country as multiple sources produce goods infringing it while none of them has an incentive to protect its value as a signal of quality desired by consumers”).

439. It is important to note that consumers do not necessarily get inferior products due to the lack of trademark protection. For example, many counterfeit products in China are made using the same raw materials and design patterns. The products are counterfeits because the manufacturers did not have authorization from the rights holders at the time of production, rather than because they used inferior raw materials or production processes. Indeed, some of the counterfeiters were former



There are several additional benefits that are unique to China and are seldom mentioned by commentators. First, compared to copyrights and patents, trademark protection will create fewer obstacles to China's modernization efforts. Trademarks "were a state planning tool before they became a marketing device and private property,"<sup>440</sup> and trademark registrations continued even during the Cultural Revolution, although they have been decentralized<sup>441</sup> and politicized,<sup>442</sup> and manufacturers had used such "politically correct" pseudonyms and non-identifying labels as "Red Flag," "East Wind," and "Worker-Peasant-Soldier."<sup>443</sup> By contrast, copyright protection affects the country's ability to maintain cultural and media control and may have a negative impact on its extensive propaganda efforts,<sup>444</sup> while patent protection slows down the country's efforts by draining foreign exchange reserves in the form of royalty and license fee payments. It is, therefore, no surprise that the 1982 Trademark Law was the first to be enacted after China's reopening in the late 1970s, while the 1990 Copyright Law was the last to be enacted, only after significant pressure by the United States.<sup>445</sup>

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contractors and had prior authorization to use the related design patterns.

440. FENG, *supra* note 67, at 344.

441. *See id.* at 293 (noting that trademarks "survived China's socialist transformation of the 1950s, and registration continued even during the Cultural Revolution (1966-1976), except that, from today's point of view, it was decentralized and 'irregular'").

442. TAN, *supra* note 227, at 10 (noting that "[t]rademarks were effectively politicized, and common trademarks became the targets of political theatre").

443. Mark Sidel, *Copyright, Trademark and Patent Law in the People's Republic of China*, 21 TEX. INT'L L.J. 259, 272 (1986); *see also* ANDREW MERTHA, *THE POLITICS OF PIRACY: INTELLECTUAL PROPERTY IN CONTEMPORARY CHINA* 197 (2005) (noting that "trademarks existed throughout the PRC, even during the Cultural Revolution, although . . . the constriction in the universe of 'politically correct' brand names . . . often obscured the identify of the actual manufacturer—and in the process made trademarks largely meaningless"); Yu, *Piracy, Prejudice, and Perspectives*, *supra* note 259, at 21-22 (discussing the impact of Great Proletariat Cultural Revolution on intellectual property protection in China).

444. *See* MERTHA, *supra* note 443, at 133-34 (noting that "[t]he copyright bureaucracy . . . is embedded within a *xitong* [functional bureaucratic system] that concerns itself with cultural, ideological, and value-laden media and is therefore involved in a more politically sensitive environment, even if technical copyright issues themselves are no more or less 'political' than those pertaining to patents or trademarks"); *id.* at 140 (noting that the Press and Publications Administration, the parent body of the National Copyright Administration, "is concerned mainly with censorship and has no interest in promoting the rights of authors or creating a free market in publishing" (quoting ECONOMIST INTELLIGENCE UNIT, *CHINA HAND: THE COMPLETE GUIDE TO DOING BUSINESS IN CHINA* 51 (1999))); *see also* Yu, *Piracy, Prejudice, and Perspectives*, *supra* note 259, at 28-32 (discussing the Chinese censorship and the information control policy).

445. *See* Naigen Zhang, *Intellectual Property Law in China: Basic Policy and New Developments*, 4 ANN. SURV. INT'L & COMP. L. 1, 8 (1997) (attributing the delay of implementing copyright law to China's concern about controlling ideology by regulating publications).

Second, although trademark protection requires local consumers to pay a premium for the well-known foreign brand, it encourages local companies to catch up and compete with the famous Western brands by developing more attractive products and focusing on brand positioning. The fact that the Chinese commercial market is still at an early, immature stage will only serve to benefit Chinese companies. As one commentator noted, "China's market is . . . dynamic, with consumer loyalty still developing; consumers are still experimenting, and brands come and go with great speed."<sup>446</sup> Under such rapidly-changing conditions, local companies have the opportunity to attain market position and develop the next promising brands.

Indeed, the ability to develop local brands has been greatly enhanced by the failure of foreign businesses to understand the local Chinese market conditions.<sup>447</sup> Studies have "estimated that less than 10 percent of Chinese consumers have the level of disposable income that can afford to buy Western products."<sup>448</sup> Notwithstanding this financial reality, many foreign businesses only focus on the high-end market, ignoring the mid-to-low-end customers. A case in point is the microwave market, which Galanz has overtaken recently. "[I]n 1993 only 1% of Chinese consumers had microwaves. Consumption grew—but not in the pattern expected. By early 2000, nearly 90% of the

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446. See CHEE, *supra* note 152, at 30; see also Rick Yan, *Short-Term Results: The Litmus Test for Success in China*, in HARV. BUS. REV., *supra* note 208, at 79, 95 (noting that "[t]he Chinese market is in such tumult that it is constantly challenging the positions of incumbents and creating fresh opportunities for innovative competitors that know how to change the rules of the game"). As one commentator noted:

In a developing immature market like China, many precious bullets in the war for the customer are wasted just to educate the customer and the trade why their products are better and how the trade needs to handle its products and/or services. Often what happened was the "first mover" foreign competitor did build up significant market share against local competitors and enjoyed comfortable margins in the beginning. These high margins, however, were not enjoyed for long, since the next major foreign competitor, claiming no. 1 status in their home markets (be it Japan, Germany, Australia, etc.), would come along with an aggressive market strategy. The incumbent, having fired most of its bullets, would prefer to cut back on marketing spending to reap back its original heavy investment in marketing and distribution; instead, the new onslaught of competitors forced them to spend heavily to defend their market positions again and again.

CHAN, *supra* note 169, at 54-55.

447. See CHEE, *supra* note 152, at 31 (observing that "foreign multinational companies . . . are failing to understand the difference between buyer aspiration and effective demand"); see also Rick Yan, *To Reach China's Consumers, Adapt to Guo Qing*, in HARV. BUS. REV., *supra* note 208, at 123, 125 (noting that "[f]oreign companies seeking to win a piece of this growing market must adapt to *guo qing* . . . , which means 'national characteristics' or 'a country's special circumstances'").

448. CHEE, *supra* note 152, at 31.

market was in cheaper models, with the Chinese company Galanz dominating.”<sup>449</sup>

Unlike foreign companies, Chinese companies usually “produce their own brands at low cost first, then gradually develop very strong brand positioning.”<sup>450</sup> For example, instead of competing directly against such famous Japanese household brands as Panasonic and Fujitsu, Haier “aimed for the middle ground, positioning itself between the leading overseas innovators and lower cost, lower quality domestic rivals . . . .”<sup>451</sup> Once Chinese companies have built up their market share, they will focus on developing their brand positioning. Indeed, Chinese companies have been spending a substantial amount of money on brand building. According to Nielsen Media Research, “only two foreign brands were ranked among the top ten most advertised products in China (Procter and Gamble’s ‘Crest’ and ‘Safeguard’).”<sup>452</sup>

Some commentators have observed that Chinese companies are actively purchasing Western companies and their brands for instant name recognition,<sup>453</sup> rather than spending time to build brand loyalty, as Japanese companies have done. As a China specialist noted, “Chinese companies don’t have that much choice but to acquire overseas companies. ‘Very few companies can build organically any more. If they wait 10 to 15 years, they could be dead.’”<sup>454</sup> This observation might be true. Nevertheless, foreign companies are also actively purchasing Chinese companies to obtain access to the local market. As one commentator noted:

[F]oreign companies have . . . gradually overtaken Chinese famous marks and brand names by way of forming joint ventures with

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449. *Id.*

450. *Id.*

451. *How China’s Most Valuable Brand Found Its Niche*, MANAGING INTELL. PROP., Apr. 1, 2005, at 38.

452. CHEE, *supra* note 152, at 31-32.

453. See SHENKAR, *supra* note 153, at 158 (noting that some Chinese companies “have found a quicker and cheaper way [to build brand names], buying the trademarks of companies in distress . . . , taking over customers with whom they have done business as an OEM [original equipment manufacturer] . . . , or via an alliance with a branded manufacturer”); David Barboza, *Name Goods in China but Brand X Elsewhere*, N.Y. TIMES, June 29, 2005, at C1 (discussing the strategy of Chinese companies of acquiring well-known brand names, such as IBM, Maytag, RCA, to obtain access to global distribution networks, sophisticated research and development, and recognizable brand names). But see Steve Lohr, *I.B.M. Sought a China Partnership, Not Just a Sale*, N.Y. TIMES, Dec. 13, 2004, at C1 (reporting about how IBM Chairman Samuel Palmisano “traveled to Beijing to explore the sale of the company’s personal computer business” (emphasis added)).

454. Barboza, *supra* note 453 (quoting Joe Chang, China specialist at McKinsey & Company).

Chinese companies. For example, after Kodak bought a Xiamen film company, the Chinese mark "Fuda" disappeared from the market. Although another Xiamen company's mark "Tong Si Da" survived after forming a joint venture with General Electric (GE), only 5% of its products were sold in the domestic market with the Chinese trademark. The other 95% of its products were exported to the US and other markets using GE's trademark.<sup>455</sup>

Third, trademark protection creates the least friction with the Chinese culture, and the justification for trademark protection, in particular its emphasis on goodwill, is easy for the Chinese to understand. Indeed, the importance of "face" runs deep in the Chinese culture and helps explain why it is important to protect trademarks.<sup>456</sup> Just as "face" is about an individual's self-respect, prestige, and social standing, trademarks, especially well-known ones, provide information about the quality, reputation, and commercial standing of the products. In the wake of the WTO accession, China strengthened its protection of well-known marks. Such protection is particularly important, as licensed foreign products are increasingly sold in different parts of the country.

Finally, "[t]he Chinese themselves are . . . very brand conscious, a legacy of Confucian hierarchy and of their imperial past where rank was prominently displayed on bureaucrats' clothing."<sup>457</sup> The fact that the Chinese language consists of pictorial characters and "is strongly visual and semiotically promiscuous" also make trademarks and other related symbols more important in the Chinese culture.<sup>458</sup> Moreover, the building of brands "fits with the government's strategy of consolidating strategic industries . . . to create national champions that can hold their own in global markets and . . . to restore its imperial glory."<sup>459</sup> As Oded Shenkar noted:

From building the world's tallest building to hosting the Olympics, which is a traditional coming-of-age for Asian nations, symbols are important to the Chinese regime, whose legitimacy increasingly rests on delivering economic performance and growth on the one hand and on nationalist sentiments on the other. Showcase projects are there to impress citizens and outsiders with the regime's capabilities and signal that the aspiration to be counted among the world's leading nations is attainable.<sup>460</sup>

455. Li, *The Wolf Has Come*, *supra* note 28, at 96.

456. See *supra* Part III.B (discussing "face," or *mianzi*, in the Chinese culture).

457. SHENKAR, *supra* note 153, at 157.

458. BOB HODGE & KAM LOUIE, *THE POLITICS OF CHINESE LANGUAGE AND CULTURE: THE ART OF READING DRAGONS* 8 (1998).

459. SHENKAR, *supra* note 153, at 158.

460. *Id.* at 36.

While the Beijing Olympics, no doubt, will provide an opportunity for China to improve intellectual property protection, it is not the only major opportunity. Two years after the event, China will hold the World Expo in Shanghai. The importance of this event is not to be understated. After all, it was the 1873 international exposition in Vienna that led to the creation of the Paris Convention for the Protection of Industrial Property, which set the modern standard for worldwide protection of patents, trademarks, and other industrial property rights.<sup>461</sup>

Nevertheless, as much as China wants to showcase its improvement in intellectual property protection through these major international events, its showcase might be limited to the major cities and the coastal areas. As Part III pointed out, China is a “country of countries,” and what happened in its major cities may not be extended to other cities, townships, or the rural areas. This is particularly true with respect to trademark protection. Due to the enormous disparity in wealth and purchasing power, the goods that are in high demand in the inland and rural areas may be quite different from those in the major cities. The extent of counterfeiting and the protection of trademarks, as a result, may vary significantly.

#### CONCLUSION

In the late 1980s, the United States pursued a very aggressive foreign intellectual property policy toward China. It repeatedly threatened the country with economic sanctions, trade wars, non-renewal of most-favored-nation status, and opposition to entry into the WTO. Although the policy had initial success, leading to the promulgation of the 1990 Copyright Law, a complete overhaul of the Chinese intellectual property system, and the creation of the current enforcement infrastructure, the policy had become largely ineffective by the mid-1990s. It cost the U.S. government not only credibility before the Chinese leaders, but also the support of its business constituency, which increasingly criticized the administration for having a counterproductive U.S.-China foreign policy. Even worse, the policy fostered resentment among the Chinese while jeopardizing the United States’ longstanding interests in promoting free trade, human rights, and rule of law.

In 2001, China became the 143rd member of the WTO, less than two decades years after it (re)introduced a Western-style intellectual

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461. See Yu, *Currents and Crosscurrents*, *supra* note 105, at 343-48 (discussing the 1873 international exposition in Vienna and the origin of the Paris Convention).

property regime. China's WTO accession presents both an opportunity and a danger. While it is beneficial to have China playing by the same rules like all other countries, a blunder by this emerging trading power could ruin the entire international trading system. Policymakers, therefore, are actively exploring options to induce China to play by the WTO rules, in particular those concerning protection of intellectual property rights under the TRIPs Agreement. In exploring these options, countries need to be careful about how they engage China in the process, especially at a time when the country is still learning how to comply with the different demanding requirements of the WTO. A misstep in the U.S.-China intellectual property policy of the 1990s created "a cycle of futility" that backfired on the United States' longstanding interests. A misstep today would have similar effects.

The piracy and counterfeiting stories about China have been told often, but they remain important, and their plots continue to change. A careful study of these plots not only reveal the country's rapidly-changing local conditions, but also provide critical insights into the difficulty countries face in complying with strong intellectual property standards, the difference between the Chinese and Western legal cultures, the unique nature of intellectual property protection, and the different considerations and concerns less developed and transition countries have over the one-size-fits-all intellectual property system pushed by the European Communities and the United States.

At the ceremony of China's WTO accession at the Fourth WTO Ministerial Conference in Doha, former Chinese Minister of Commerce Shi Guangsheng declared: "China's accession to the WTO is not only in the interest of China, but also in the interest of the world."<sup>462</sup> While the piracy and counterfeiting stories discussed in this Article feature China primarily, a better understanding of these stories will benefit not just the Chinese, but every member of the international trading community.

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462. Guangsheng Shi, *Introduction: Working Together for a Brighter Future Based on Mutual Benefit*, in CHINA'S PARTICIPATION IN THE WTO, *supra* note 68, at 15, 17.